

State Sales and Use Tax Exemptions

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Remaining Exemptions, Dan Ettefagh

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Medical and Food Related Exemptions

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Overview

- Three Major Sales and Use Tax Exemptions
- History
- Revenue and Recent Challenges
- Options



Three Major Sales and Use Tax Exemptions, FY 07-08/FY 08-09

Food



\$582.2 Million

G.S. 164.13B

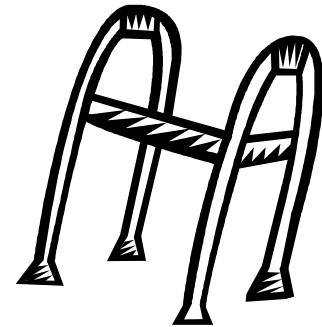
Prescription
Drugs



\$387.8 Million

G.S. 164.13(12)

Durable
Medical Equip



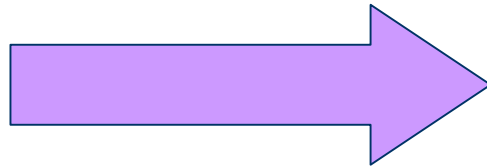
\$25.5 Million

G.S. 164.13B



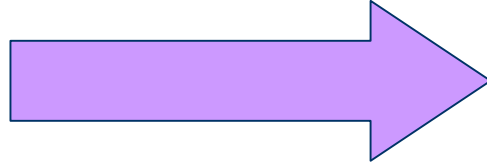
History of the Sales and Use Tax and Food

1933



Exempts food for human consumption

1961

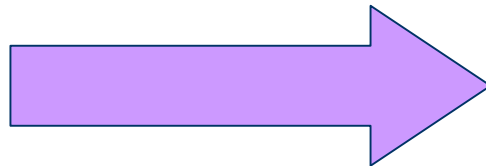


Repeals food exemption



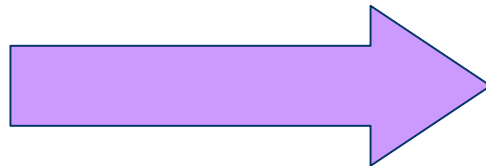
History of the Sales and Use Tax and Food

1998



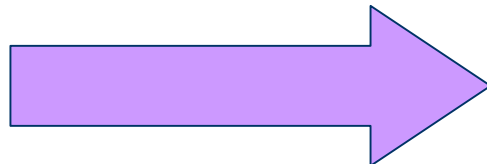
Eliminates the State sales and use tax rate on food

2000



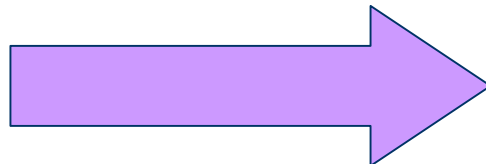
Enters Streamlined Sales Tax Project

2001



Redefines food into two types

2003



Determines prepared food is taxable by the state



Food for Home Consumption

- Definition—G.S. 105-164.13B
- Exempt unless it is defined as:
 - Dietary supplements
 - Vending machine items
 - Prepared food
 - Soft drinks
 - Candy



Food for Home Consumption

Fiscal Year 08-09

- Sales and use tax rate
 - State rate 0%
 - Local rate 2%
- State exemption \$582.2 M
- Local revenue \$262.4 M



Prepared Food

- Definition—G.S. 105-164.3(28)
- Subject to the State and local sales tax if:
 - It is sold in a heated state
 - It consists of two or more foods
 - Foods mixed or combined by retailer
 - It is sold with eating utensils



Prepared Food

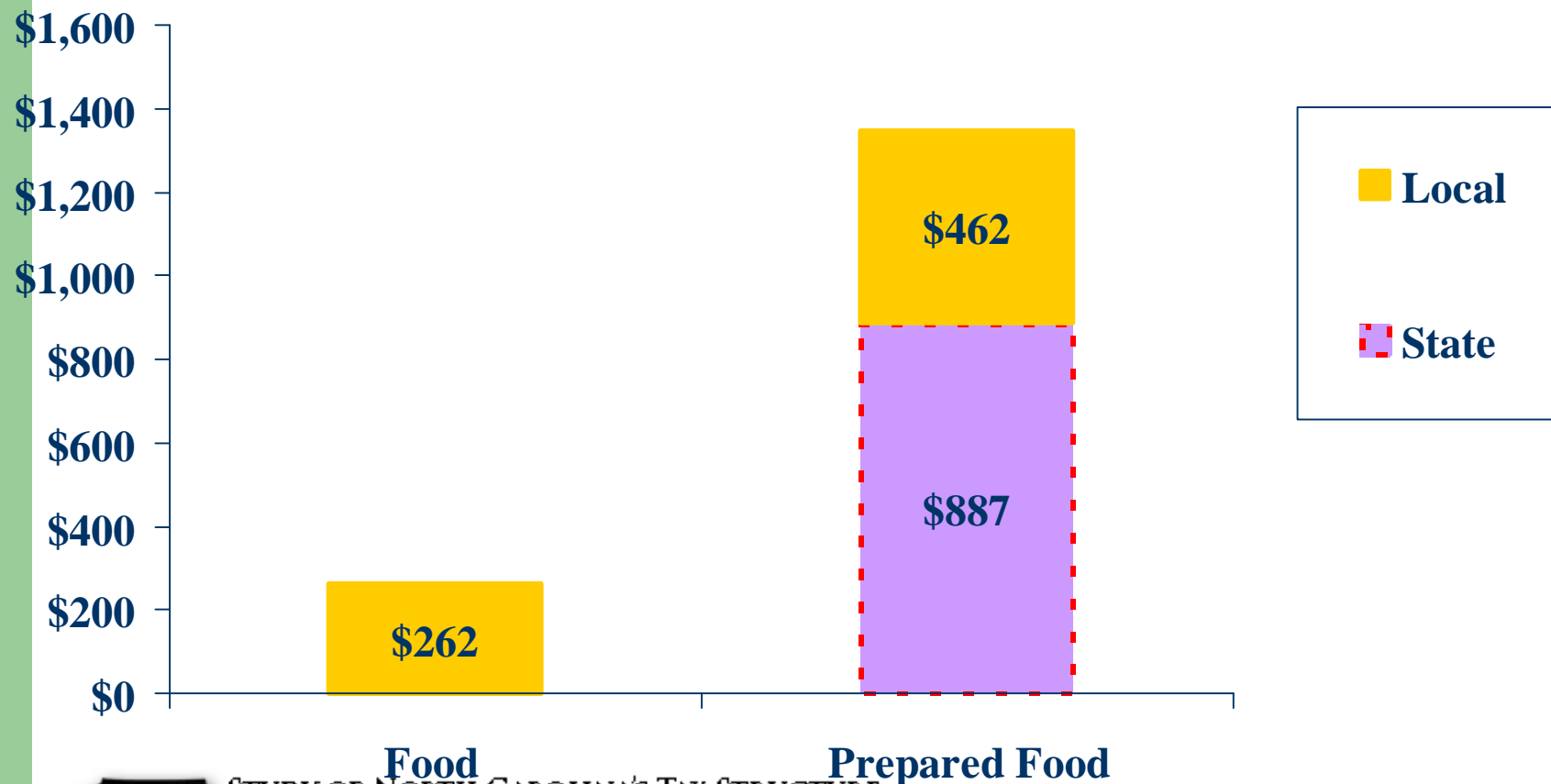
Fiscal Year 08-09

- Sales and use tax rate 6.75%
 - State 4.44%
 - Local 2.31%

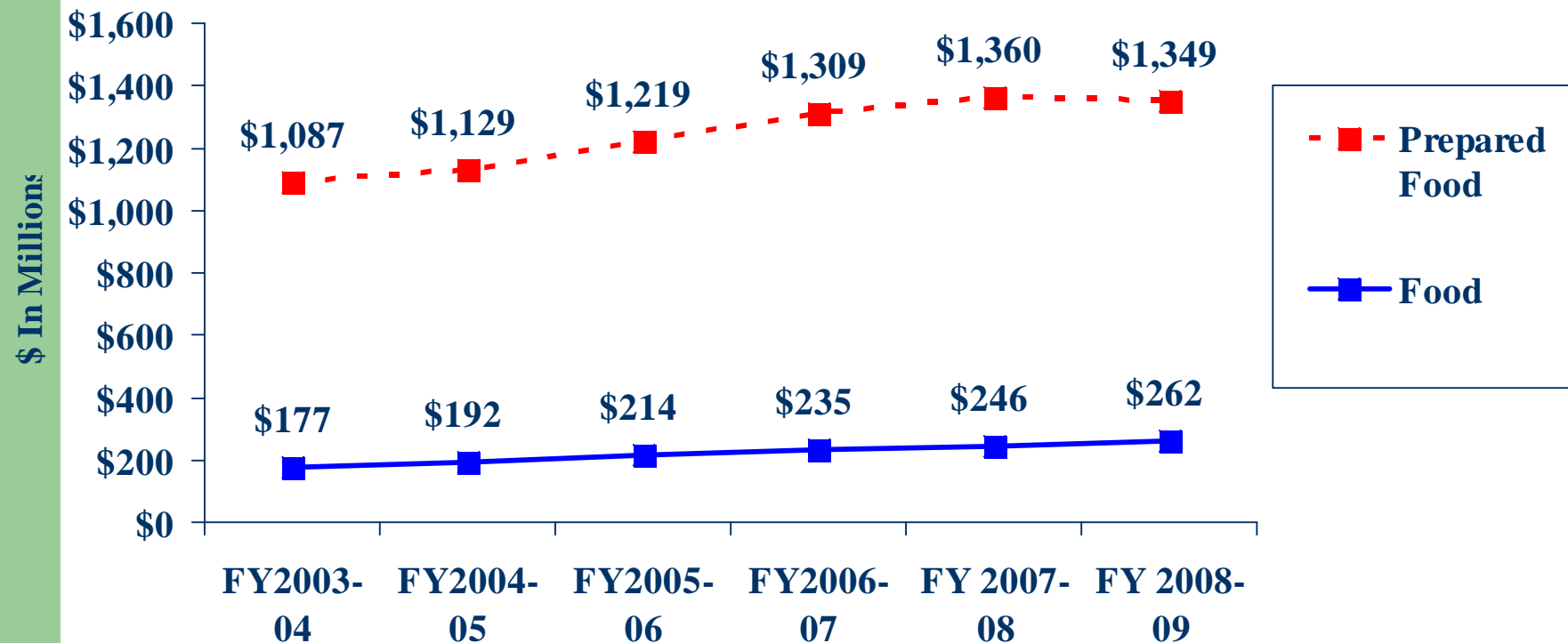
- Revenue \$1.4 Bill.
 - State \$886.6 Mill.
 - Local \$462.0 Mill.



Tax Collections on Food and Prepared Food, FY08-09



Sales Tax Collections on Food and Prepared Food (\$ In Millions)



Source: 2004-2009 Statistical Abstract, North Carolina Department of Revenue, Tables 32, 56 and 57 in most publications



Recent Challenges

- Blurred line between food and prepared food
- Difficulty in administering different rates



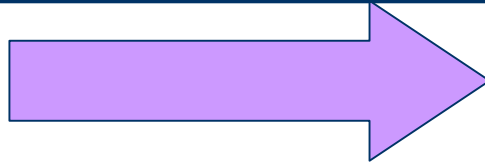
Options?

- Past recommendations
- How other states tax food
 - U.S.
 - Streamlined Sales and Use Tax Project
- Revising tax treatment



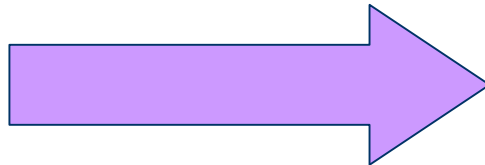
Past Recommendations on the Taxation of Food

1951



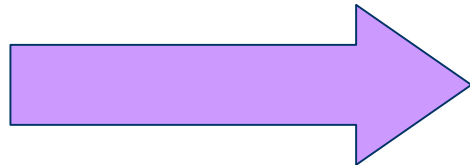
Eliminate food exemption

1984



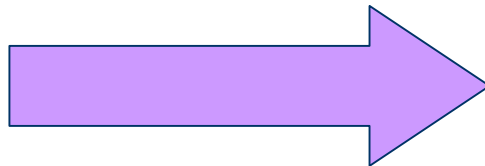
Provide tax credit to low-income families

1991



Maintain tax on food

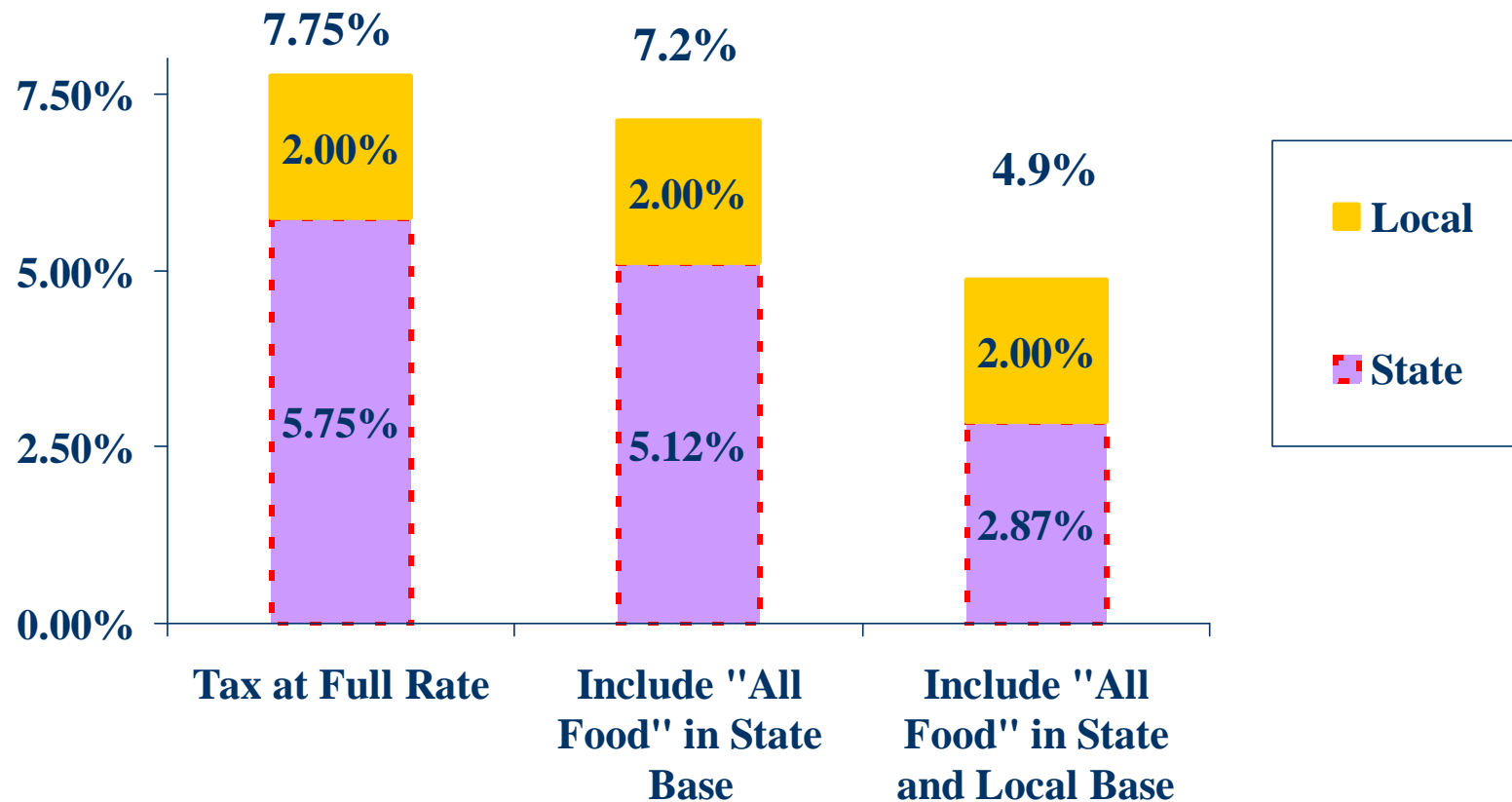
2008



Eliminate food exemption



Options for Taxing Food and Prepared Food, FY 2010-11

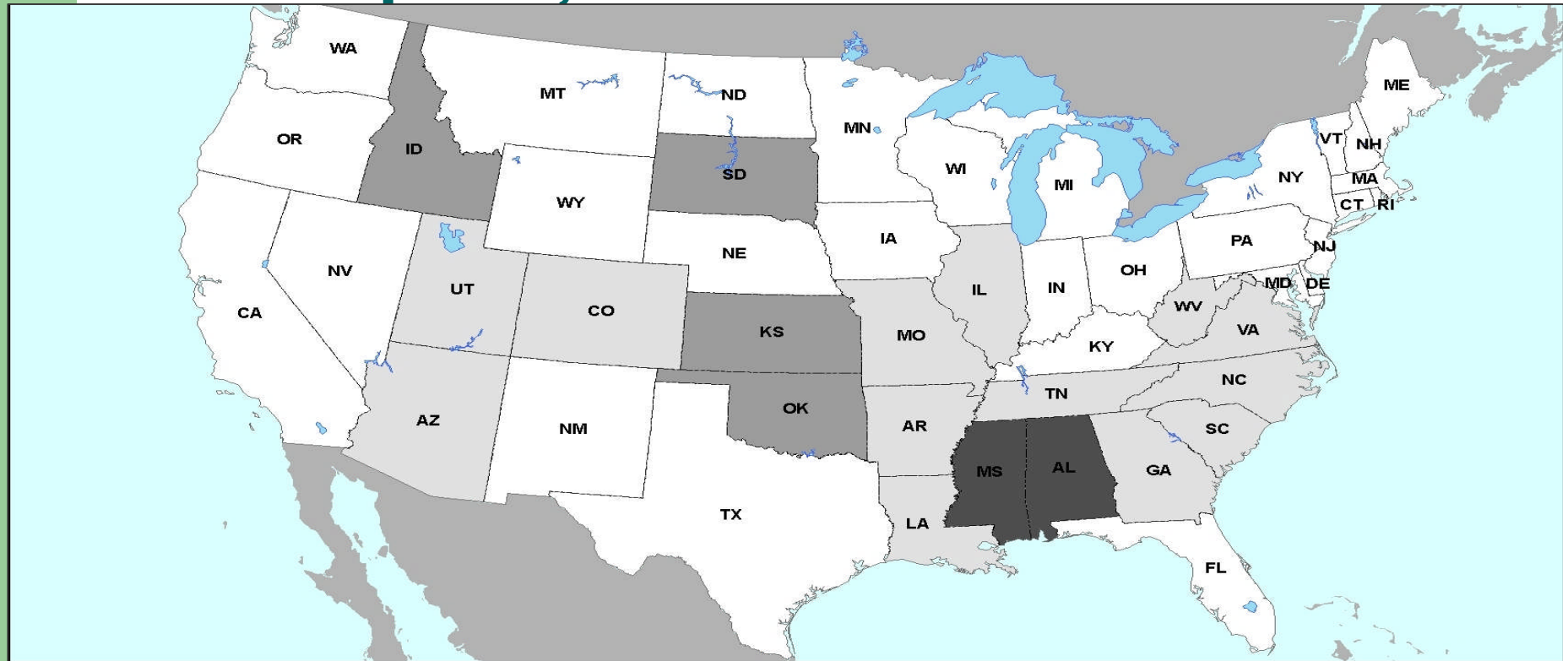


Tax Treatment of Food, U.S.

- Two levy the full rate
- Seven levy reduced rates
- Six apply local tax
- 26 states exempt food
- Four levy full rate but w/ caveats
- Five no sales tax

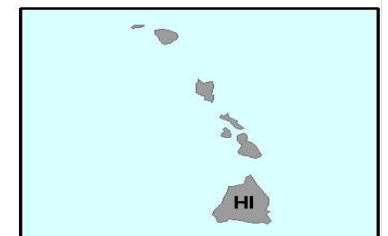


Tax Treatment of Food for Home Consumption, U.S.



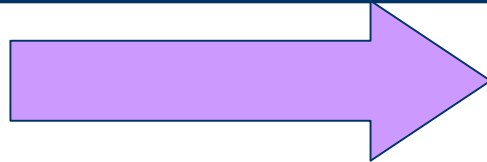
Tax Treatment of Food For Home Consumption

- | | |
|-------------------------------------|---|
| <input checked="" type="checkbox"/> | Levy a State sales tax on food consumed at home at the full rate |
| <input type="checkbox"/> | Levy a State sales tax at a reduced rate, or food is only taxed by local governments |
| <input type="checkbox"/> | Levy a State sales tax on food, but provides relief to low income taxpayers through tax credits |
| <input type="checkbox"/> | No State sales tax or exempts food from State and local rate |



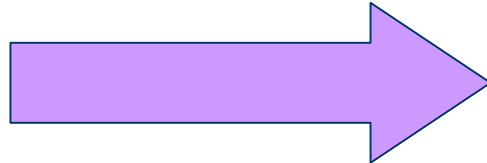
Sales and Use Tax History, Rx Drugs & Medical Equipment

1933



Prescription drugs taxed

1939



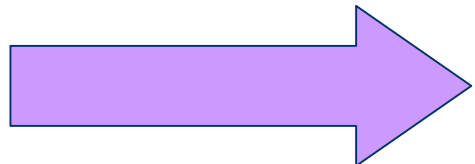
Prescription drugs tax exempt

1943



Prosthetics tax exempt

1961

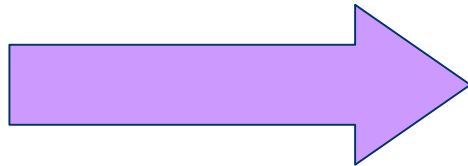


Medicine sold on prescription by
physicians and dentist



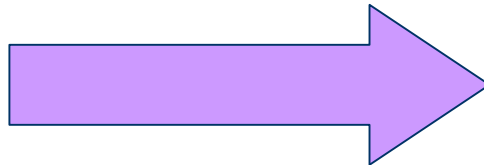
Sales and Use Tax History, Rx Drugs & Medical Equipment

1988



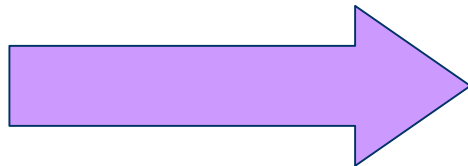
Exempts insulin prescribed by
physicians and veterinarians

1999



Repeals tax for prescription
drugs sold to hospitals

1999



All durable medical equipment
becomes tax exempt

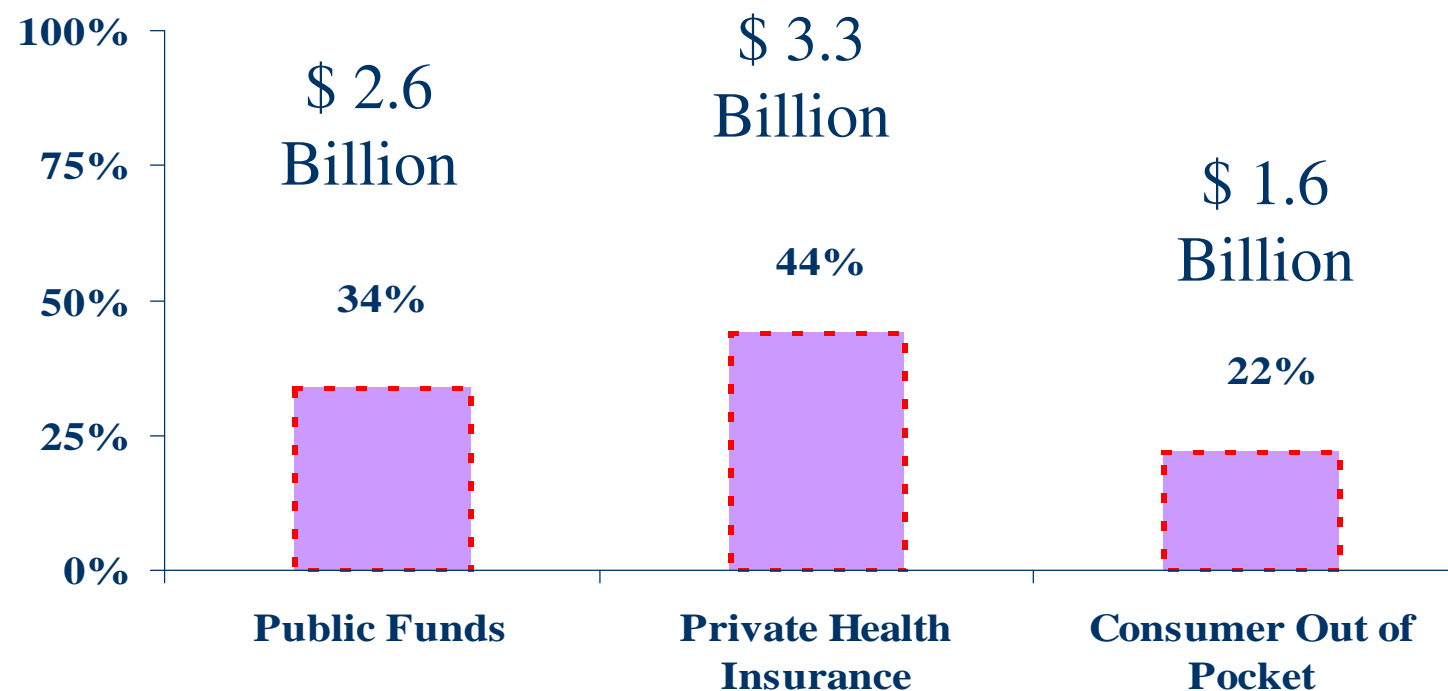


Other States Tax Treatment, Rx Drugs

- Two states tax Rx drugs
 - IL—1% sales tax
 - LA—Local sales tax
- 43 states exempt Rx Drugs
- Five states no sales tax



Percent of Drug Expenditures, by Type of Payer, 2006



Source: Kaiser Family Foundation. "Prescription Drug Trends." Published September 2008.



STUDY OF NORTH CAROLINA'S TAX STRUCTURE
INTERIM JOINT HOUSE AND SENATE FINANCE COMMITTEES

Agricultural and Industrial Related Exemptions

**Martha Walston,
Fiscal Research
Division, NCGA**



Categories

- Items sold to or produced by farmers
- Manufacturing items
- Packaging items
- Items sold to commercial laundries
- Computer software



Items Sold to Farmers

- Items used in planting, cultivating harvesting, or curing of crops or in production of dairy products, eggs, or animals.
- Commercial fertilizer, lime, land plaster, plastic mulch, plant bed covers, potting soil, baler twine, and seeds
- Farm machinery, attachment and repair parts and lubricants for machinery
- Horses and mules
- Containers
- Grain, feed, or soybean storage facilities.
- Fuel other than electricity used for farm purposes
- (\$54.3M)



Items Sold to Farmers

- Facilities, equipment, and supplies used for commercial purposes for housing, raising, or feeding animals (\$10.8M)
- Tobacco items (\$0.1M)
- Logging machinery, attachments, repair parts, lubricants and fuel for machinery used in commercial logging business (\$7.0M)
- Substances used on animals or plants (\$94.1M)



Items Produced by Farmers

- Products of forests and mines in their original state
- Products of a farm sold in their original state by the producer if the producer is not primarily a retail merchant
- Farm products sold to manufacturer for further manufacturing or processing



Manufacturing Items

- Manufactured products produced and sold to other manufacturers, producers, or retailers for resale
- Personal products sold to manufacturer that become part of manufactured products
- Machinery and equipment used by certain manufacturers and on which a 1% privilege tax with \$80 cap is imposed
- Effective July 1, 2010, fuel and electricity sold to manufacturer for use in connection with operation of manufacturing facility



Manufacturing Items

- Sales of the following:
 - Broadcasting equipment to cable providers (\$12M)
 - Towers and broadcasting equipment to FCC licensed radio or television companies (\$1.5M)
 - Central office equipment, switchboard equipment, private branch exchange equipment to telephone company providing telecommunications service to subscribers on a commercial basis (\$31M)



Manufacturing Items

- Sales of products of waters in their unmanufactured or original state.
- Sales of boats, fuel, machinery, equipment, and supplies used by one of the following in a commercial operation:
 - Holder of commercial fishing license
 - Holder of shellfish license
 - Operator of for-hire boat (\$1.6M)



Packaging Items

- Items used for packaging, shipment, or delivery of personal property sold at wholesale or retail and
 - Considered part of sale
 - Delivered with the personal property to the customer
- Container used as packaging by the owner of the container to deliver personal property to a purchaser and required to be returned
- (\$61.7M)



Commercial Laundries, Pressing and Dry Cleaning Establishments

- Materials used for identification of garments
- Wrapping paper, bags, hangers
- Detergents and cleaning fluids
- Machinery, parts and accessories, and lubricants
- Fuel, other than electricity, used in the service
- (\$1.7M)



Computer Software

- Custom computer software
- Computer software that becomes a component part of other computer software offered for sale
- Computer software that meets any of the following:
 - Designed to run on an enterprise server operating system
 - Sold to a person who operates a datacenter and is used within the datacenter.
 - Sold to person who provides cable service, telecommunications service, or video programming and is used to provide ancillary service, cable service, Internet access service, telecommunications service or video programming
- (\$9.6M)



Incentive Related Exemptions

**Canaan Huie, House
Finance Counsel,
NCGA**



Sales Tax Exemptions Economic Development

- Major Recycling Facilities
- Interstate Air Couriers
- Interstate Air Passenger Carriers
- Interstate Air Businesses
- Datacenters
- Railroad Intermodal Facilities



Exemptions

Major Recycling Facilities

- Enacted in 1998, effective July 1, 1998
- Anticipated beneficiary was Nucor
- Exemption of the following items sold for use at the facility
 - Lubricants and other additives for motor vehicles and other equipment
 - Non-capitalized materials, supplies, and parts
 - Electricity
- Fiscal information unavailable from DOR due to taxpayer secrecy laws
- Original estimates from Fiscal Research put the cost at \$270,000



Interstate Air Couriers

- Enacted in 1998, effective January 1, 2001
- Anticipated beneficiary was Fed Ex
- Exemption of the following items sold for use at the hub:
 - Aircraft lubricants, repair parts and accessories
 - Materials handling equipment and racking systems
- Fiscal information unavailable from DOR due to taxpayer secrecy laws
- Original estimates from Fiscal Research put the cost at \$160,000



Interstate Air Passenger Carriers

- Enacted in 1999, effective May 1, 1999
- Anticipated beneficiaries were US Air (now US Airways) at CLT and, later, Midway Airlines at RDU
- Exemption of the following items sold for use at the hub:
 - Aircraft lubricants, repair parts, and accessories
 - Aircraft simulators for flight crew training (subject to 1%/\$80 rate in 1999, complete exemption in 2005, added for other taxpayers in 2009)
- Fiscal information unavailable from DOR due to taxpayer secrecy laws
- Original estimates from Fiscal Research put the cost at \$1.2 million



Interstate Air Businesses

- Enacted in 2004, effective October 1, 2004
- Anticipated beneficiary was Timco
- Exemption of the following items sold to an interstate air business
 - Component parts or lubricants for commercial aircraft used during maintenance, repair, or overhaul
- Fiscal information unavailable from DOR due to taxpayer secrecy laws
- Original estimates from Fiscal Research put the cost at \$4 million



Eligible Internet Data Centers

- Definition
 - Internet service providers and Web search portals
 - Facilities all located on one parcel of land or commonly owned contiguous parcels
 - Located in a lower-tiered area
 - Commerce certifies that the taxpayer will make an investment of at least \$250 million within 5 years
- Note
 - Certain types of data centers that don't meet these requirements are still eligible to have some items subject to the 1%/\$80 excise tax rather than the sales and use tax



Eligible Internet Data Centers

- Enacted in 2006, effective October 1, 2006
- Anticipated beneficiary was Google
- Exempts the following items sold to an eligible Internet data center
 - Electricity
 - Eligible business property
 - Capitalized under the Code and
 - Used for one of the following
 - Provision of Internet service or Web search portal services, including heating and cooling equipment for the property
 - Generation, transformation, transmission, distribution, or management of electricity
 - Related computer engineering or computer science research
- DOR estimates this exemption cost \$1.8 million in FY 07-08



Railroad Intermodal Facilities

- Enacted in 2007, effective January 1, 2007
- Anticipated beneficiary was Norfolk Southern
- Exempts the following items sold to the owner or lessee of an intermodal railroad facility that reside at the facility
 - Intermodal cranes
 - Intermodal hostler trucks
 - Railroad locomotives
- Fiscal information unavailable from DOR – impact of less than \$200,000 expected from all incentives (income/franchise taxes, sales tax exemptions, sales tax refunds) for railroad intermodal facilities



Remaining Sales Tax Exemptions

**Dan Ettefagh,
Legislative Drafting
Division, NCGA**



Broad Rationales for Remaining Sales Tax Exemptions

- Prohibitions
- Alternative tax-based exemptions
- Exemptions for products used outside of the State
- Entity- and transaction-based exemptions
- Media exemptions
- Streamlined- and final sale-based exemptions
- Miscellaneous reasons



Exemptions Stemming from Prohibitions

- Constitutional or federal law
- Sales on the Cherokee Indian Reservation (\$10M)
- Disaster relief debit card purchases



Alternative Tax-based Exemptions

- Piped natural gas taxed under Article 5E (\$110.2M)
- Motor vehicles subject to the highway use tax (\$301M)
- Motor fuel and alternative fuels (for which a refund is not allowed) subject to the motor fuels tax (\$723.5M)



Exemptions for Products Used Outside of the State

- Articles purchased for resale
- Purchases delivered outside of the State
- Sales of fuel and articles for use on ocean-going vessels



Entity- and Transaction-based Exemptions

- Entity-based exemptions
 - Purchases by the Department of Transportation
 - Purchases by State agency pursuant to valid purchase order
 - Purchases of mobile classrooms by boards of education or community colleges (\$0.5M)
 - Sales by non-profits conducted annually for fund raising (\$1.1M)
 - Sales by non-profits whose proceeds go to the State
- Transaction-based exemptions
 - Accounts of sales charged off for income purposes
 - Articles repossessed by vendors



Media Exemptions

- Lease or rental of films, transcriptions, and recordings to broadcasters (\$5M)
- Lease or rental of films for exhibition (\$2.8M)
- Audiovisual masters (\$2.2M)
- Non-subscriber sales of newspapers, door-to-door magazine sales (\$7.4M)
- Advertising supplements & printed matter distributed with newspapers (\$4.3M)
- Components of free distribution periodicals (\$5.5M)



Final Sale- & Streamlined-based Exemptions

- Sales of motor vehicle bodies
- Deposit on returnable beverage container
- Deposit on returnable replacement parts
- Separately stated installation charges (\$10.4M)
- Separately stated delivery charges for delivery of direct mail (\$0.5M)
- Certain telecommunications services (\$6.1M+)



Miscellaneous Exemptions

- Public school books (\$3M)
- Sales by blind merchants (\$0.5M)
- Water delivered by mains/pipes (\$42.5M)
- Municipal sales of electricity supplied by federal agency (\$0.3M)
- Sales of diesel used for RR cars and locomotives (\$17M)
- Articles donated by retailer or wholesaler
- Goods (other than tobacco) sold through vending machines (\$5.5M)
- Certain sales of articles to professional land surveyors (> \$0.1M)
- Interior design services “sold” with articles
- Penny vending machines (> \$0.1M)



Conclusion

- Questions?
- Comments?
- Concerns?

