


Overview of North Carolina Sales Tax

Historical Overview, Cindy Avrette
State Sales Tax Rates, Trina Griffin
Streamlined Sales Tax Agreement,
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 STUDY OF NORTH CAROLINA'S TAX STRUCTURE
INTERIM JOINT HOUSE AND SENATE FINANCE COMMITTEES

Historical Overview

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Historical Timeline ...

1777

Property Tax

- ✓ Second law enacted was new tax system
- ✓ License taxes; income tax in 1849
- ✓ Public interest to extend school term from 4 to 6 months sparked talk of tax reform in 1913

1839

**State financed free
public education**

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Historical Timeline ...

1921

Major Tax Reform

- ✓ State programs funded with local taxes
- ✓ Segregated State and local taxes
- ✓ State relinquished property tax to locals
- ✓ Relied on income, inheritance, franchise, license taxes

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Historical Timeline ...

1931

1933

Schools, roads, prisons

Sales tax

- ✓ 1931 General Assembly deadlocked and reverted to Statewide property tax; tax increases
- ✓ 1933 General Assembly enacted temporary 3% retail sales tax, tax on alcohol, and other rates

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Emergency Revenue Act of 1933

An Emergency Revenue Act passed to levy *"additional and extraordinary" taxes to meet a supreme emergency in the shrinkage of the ordinary revenues of the State and as a further relief from property taxes to provide another form of revenue for the support of the public schools of the State in substitution for the taxes levied on property for this purpose.*

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Sales Tax of 1933

- 3% sales tax on all tangible personal property except meat, bread, and flour
- Nationally
 - Mississippi enacted first sales tax in 1930
 - 23 states enacted sales tax by beginning of WWII
 - 45 states enacted sales and use tax today

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Historical Timeline ...

1935

1937

Wholesale tax rate

Single article cap

✓ Sales tax rate and a 1% wholesale tax rate on WS sales and certain consumer sales, mill machinery

✓ Single article cap of \$10; increased to \$15 in 1937

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Historical Timeline ...

1939

**Sales tax permanent and use
tax article enacted**

Exempt horses, mules, coffins

✓ Sales tax generally accepted by most citizens
as a convenient means of paying small
installments toward the support of State
government

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Historical Timeline ...

1941

1945

1947

**Exempt
food**

**Exempt
prescription
drugs**

**Exempt
fuel sold
to farmers**

✓ Exemptions based on identity of consumer
✓ Exemptions based on type of transaction or
property

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The Sales Tax Study of 1951

- Eugene Shaw, Commissioner of Revenue
- Problems and Solutions
 - Single article cap; Eliminate it
 - Exemptions; Eliminate all exemptions except ...
 - Sales in interstate commerce
 - Sales to governmental units
 - Sales of productive equipment to farmers & manufacturers
 - Sales of raw materials that become component part

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The Sales Tax Study of 1951

- Extend sales tax to ...
 - All forms of amusements and entertainment
 - Lodging accommodations
 - Automotive service and repairs
 - All services and repairs to tpp
 - Repair services to plumbing, electrical, heating, and air conditioning equipment

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Historical Timeline ...

1955	1957
Single article cap repealed	Combined sales and use tax article enacted
Lodging taxed	WS tax rate extended
WS tax rate extended	Exemptions expanded
1%, \$80 cap on vehicles, planes	Tax on funeral expenses

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Historical Timeline ...

1961	1961-1983
WS tax repealed; 1%, \$80 tax rate enacted; 1% rate added	Tax on vehicles, planes, railway cars, and boats
Food exemption repealed	

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Historical Timeline ...

1971	1983	1985
1¢ local sales tax authorization	Two ½¢ local sales tax authorizations	
Distributed point of sale	Distributed per capita with use restricted	
	Exempt food purchased with food stamps	

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Historical Timeline ...

1987	1989	1998
Merchants discount repealed	Sales tax on vehicles replaced with highway use tax	Exempt food Use of exemptions and refunds as economic development incentives

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Historical Timeline ...

2000	2001	2007	2009
SSTP	Third ½¢ local sales tax authorization	Medicaid swap	Digital products

✓ Changing world: technology; goods v. services

✓ Integration of State and local revenue sources and funding responsibilities

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Sales Tax Revenues

Fiscal Year	Sales Tax Revenue
1933-34	\$6,011,700
1940-41	14,256,941
1949-50	41,869,874
1970-71	285,893,056
1980-81	737,098,123
1990-91	1,682,340,881
2000-01	3,435,558,577
2008-09	4,677,961,056

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State General Sales Tax Rate Changes

- 1933: 3% sales tax rate
- 1991: 4% sales tax rate
- 2001: 4.5% sales tax rate, temporary
- 2005: 4.25% sales tax rate, temporary
- 2007: 4.25% sales tax rate, permanent
- 2009: 5.25% sales tax rate, temporary
- 2009: 5.75% sales tax rate, Medicaid Swap

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State Sales Tax Rates

Trina Griffin, Research
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Overview

- **General Rate**
- **Preferential rates**
 - Manufactured homes
 - Modular homes
 - Aircraft and boats
 - Electricity to Commercial Laundries and Dry Cleaners
 - Electricity to Manufacturers and Farmers
 - Electricity to Commercial Businesses and Residences
- **Combined general rate**
 - Spirituous Liquor
 - Telecommunications
 - Video Programming

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General Rate

- The general **State rate** of tax is 5.75%. The 1% increase enacted this year is scheduled to expire July 1, 2011.
- The **local rate** of tax varies:
 - In 91 counties, the rate is 2%, for a combined State and local rate of **7.75%**.
 - In Alexander, Catawba, Cumberland, Haywood, Martin, Pitt, Sampson, and Surry, the rate is 2.25%, for a combined State and local rate of **8%**.
 - In Mecklenburg, the rate is 2.5%, for a combined State and local rate of **8.25%**
- Items that are subject to state sales tax are also subject to the local sales and use tax.

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Preferential Rates

- Manufactured homes
- Modular homes
- Aircraft and boats
- Electricity
 - Commercial Laundries and Dry Cleaners
 - Manufacturers and Farmers
 - Other Commercial Businesses and Residences

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Manufactured Homes: Current Law

- Current Rate – 2%/\$300 cap.
- Revenue: \$15.9 million.

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Manufactured Homes: History

- Prior to 1989, manufactured homes were considered motor vehicles.
- At that time, motor vehicles were subject to a sales tax of 2% with a cap of \$300.
- In 1989, the General Assembly created the Highway Trust Fund, which was funded, in part, by a highway use tax imposed on motor vehicles in lieu of the sales tax and at the rate of 3% with a \$1,500 cap (S.L. 1989-692).
- The same legislation established a separate sales tax on manufactured homes to distinguish them from motor vehicles and so they would continue to be taxed at the same rate of 2%/\$300 cap.
- There have been no rate changes since 1989.

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Modular Homes: Current Law

- Current rate – 2.5%/no cap; 20% of taxes collected are distributed to counties.
- Revenue = \$4.6 million.

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Modular Homes: History

- Prior to 2004, different rates applied depending on the type of frame. "On-frame," or steel frame homes, were taxed the same as manufactured homes (2%/\$300). "Off-frame," or wood frame homes, were taxed at the general rate.
- S.L. 2003-400 - Modular homes were distinguished from manufactured homes, and the rate was set at 2.5% with no cap.
- This change was proposed by the North Carolina Manufactured Housing Institute to simplify the administration of the tax.

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Airplanes and Boats: Current Law

- Current rate – 3%/\$1,500 cap.
- Revenue = \$13.2 million.

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Airplanes and Boats: History

- 1955 – \$15 maximum single article cap was repealed and 1%/\$80 cap was imposed on motor vehicles and airplanes.
- 1961 – Rate increased to 1½% and cap was increased from \$80 to \$120 for motor vehicles and airplanes.
- 1967 – Rate on boats increased to 1½% with a \$120 cap to match tax on motor vehicles and airplanes.
- 1969 – Beginning in 1969, aircraft, boats, motor vehicles, and railway cars were taxed at the same rate of 2%.
- 1983 – Cap raised to \$300.
- 1989 – Sales tax on motor vehicles converted to a highway use tax at rate of 3%, \$1,500 cap to fund the Highway Trust Fund. The cap for aircraft, boats, and railway cars was also increased to \$1,500, but rate was not changed.
- 1991 – Rate on aircraft, boats, and railway cars raised to 3% (cap remained the same).
- 2005 - Railway cars subject to general rate of tax to conform with Streamlined.
- No change on aircraft and boats since 1991.

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Electricity: Current Law

- Current rate – There are 3 different rates depending on the purchaser of electricity and the purpose for which it is used.
- Sold to:
 - Commercial laundry or dry cleaners 2.83%
 - Revenue = \$0.5 million
 - Manufacturers and farmers .8%
 - Fully exempt 7/1/2010
 - Revenue @ 1.8% = \$22 million
 - Commercial businesses and residences 3%
 - Revenue = \$105 million

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Electricity: History

- Pre-1985 – 6% franchise tax on gross receipts.
- 1985 – The 1983 General Assembly changed the rate structure to enable individuals to deduct the taxes from their federal income (S.L. 1983-1097). Effective January 1, 1985, the franchise tax was reduced to 3.22% and a State sales tax of 3% was imposed.

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Electricity: History


- 1996 – Sales tax rate on electricity and piped natural gas used by farmers, manufacturers, laundries, and dry cleaners reduced from 3% to 2.83%, effective Aug. 1, 1996; part of Bill Lee enactment (S.L. 1996-13).
- 1998 - Electricity used by a major recycling facility exempted from sales tax (S.L. 1998-55).

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Electricity: History


- 2001– Sales tax rate on electricity sold to manufacturers that use more than 900,000 megawatt-hours of electricity annually was reduced to .17%, eff. 1/1/02.
- A rate schedule was also established reducing sales tax on electricity sold to manufacturers that use more than 5,000 megawatt hours annually but less than 900,000, eff. 7/1/05 (S.L. 2001-476, as amended by S.L. 2001-487) .

<u>Megawatt hours used annually</u>	<u>Rate</u>
5,000 or less	2.83%
Between 5,000 and 250,000	2.25%
Between 250,000 and 900,000	2.0%
Over 900,000	.17%

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Electricity: History

- 2004 – Graduated sales tax rate was repealed and rate of 2.83% imposed. At the time of this act, no manufacturers qualified for the .17% rate.
- A lower rate of .17% is enacted for electricity used in an aluminum smelting facility, with an October 1, 2007 sunset.

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Electricity: History

- In 2006, the rate on electricity sold to manufacturers and farmers was reduced from 2.83% to 2.6% and an exemption was created for electricity sold to an eligible Internet data center (S.L. 2006-66).
- In 2007, a four-year phase-out of the sales tax on electricity sold to manufacturers and farmers was enacted as part of SB 3 *Promote Renewable Energy/Baseload Generation* (S.L. 2007-397):
 - Oct. 1, 2007 = 1.8%
 - July 1, 2008 = 1.4%
 - July 1, 2009 = .8%
 - July 1, 2010 = exempt

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Combined General Rate

- What is it?
 - Defined term established in S.L. 2005-276.
 - State's **general rate** (5.75%) + sum of rates of local sales tax authorized for every county (2.25%).
 - Increased from 7% to **8%**, effective September 1, 2009.
- What is subject to the combined general rate?
 - Spirituous Liquor
 - Telecommunications
 - Video Programming

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Spirituous Liquor: History

- Prior to 2001, mixed beverages were subject to sales tax but spirituous liquor was not. Spirituous liquor was subject to 28% excise tax, which was in lieu of sales tax.
- 2001 – Spirituous liquor became subject to 6% State sales tax with a corresponding excise tax reduction from 28% to 25%, eff. 2/1/02 (S.L. 2001-424). Mixed beverages continued to be taxed at combined State and local rate, which was 6.5% at the time.
- There is no local sales tax on spirituous liquor.
- 2005 – Spirituous liquor became subject to combined general rate, which was 7% at the time.

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Telecommunications: History

- Prior to 1985, the gross receipts of regulated power, natural gas, and telephone companies were subject to a 6% franchise tax.
- 1984 – Franchise tax recodified as a 3% State sales tax (no local tax) and a 3.22% franchise tax for a total rate of 6.22%.
- 1987 – Eff. 1/1/89, 6½% sales tax imposed on intrastate long-distance calls with a corresponding exemption from franchise tax; 3% sales tax on local calls; sales tax did not apply to long-distance interstate calls, telephone membership corporations, or coin-operated pay phone calls (SL 1987-557).

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Telecommunications: History


2001 – Taxes on telecommunications were simplified by applying one tax at one rate; all telecommunications became taxed equally.

- Initially, the rate was set at 4.5% in order to achieve a revenue-neutral result (SL 2001-430).
- However, before the 4.5% rate ever went into effect, the rate was increased to 6% to generate revenue during the 2001 recession (SL 2001-424).

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
Telecommunications: History

- 2005 – Combined general rate was applied to telecommunications, resulting in a 7% rate, eff. 10/1/05 (S.L. 2005-276).
- 2007 – The term “ancillary service” was adopted to conform to the SSTA (S.L. 2006-33). No change in tax treatment.

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Video Programming: History

- Prior to 2005, cable and satellite television services were taxed differently depending upon the provider of the service. Satellite service was not subject to sales tax, but cable providers were subject to a 5% local franchise tax.
- 2001 – Tax treatment of these services was equalized by imposing a 5% sales tax on direct-to-home satellite service, which was intended to be comparable to the 5% local franchise tax on cable providers. This was a recommendation of the Governor's Loophole Closing Commission (S.L. 2001-424, as amended).

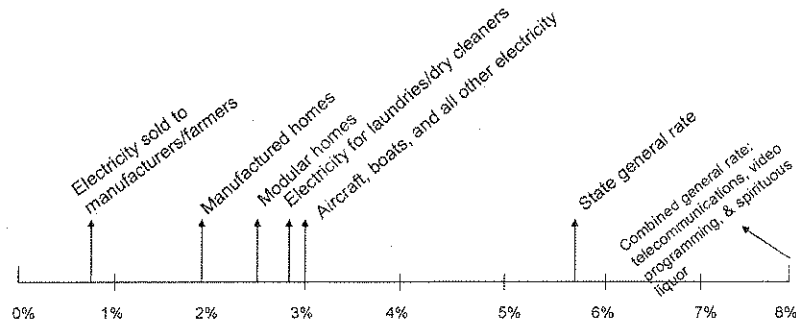
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Video Programming: History

- 2005 – Video programming became subject to the combined general rate, which was 7%.
- 2006 - *Video Service Competition Act* enacted. It did not change the amount of tax on video programming services, but it altered the calculation of and created a new distribution method for the local share of shared sales tax collections (S.L. 2006-151).

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Sales Tax Rates in NC



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Streamlined Sales Tax Agreement

Sabra Faires, Senate
Tax Counsel, NCGA

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Nature of Agreement

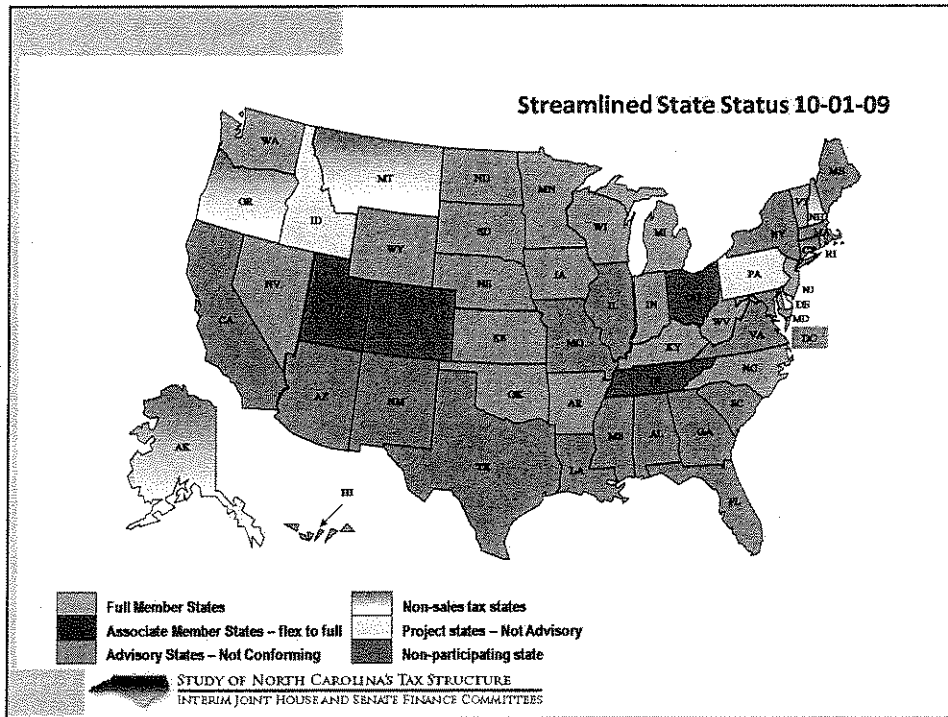
- Voluntary written agreement developed by states
- Adopted November 12, 2002, by states participating in the Streamlined Sales Tax Project and amended frequently since then
- 41 states and the District of Columbia have approved the Agreement
- 23 states have implemented the Agreement by changing their laws to conform to the requirements of the Agreement
- NC became a member of the Agreement October 1, 2005

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Becoming a Member of the Agreement

- State changes its laws, administrative rules, and policies to conform to the Agreement
- State submits:
 - Petition for membership
 - Certificate of compliance
 - Taxability matrix
- Other states review, $\frac{3}{4}$ vote required
- Recertify compliance each year

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Goals of Agreement


Simplify and modernize sales and use tax laws in order to:

- Reduce complexity for all retailers
- Promote equity between local, brick and mortar retailers and remote sellers by establishing a system that:
 - Lessens the administrative burden recognized in the 1992 U.S. Supreme Court case of Quill Corporation v. North Dakota
 - Encourages voluntary compliance by remote sellers
 - Encourages Congress to require remote sellers to collect for the member states
- Relieve consumers of the obligation to report use tax on purchases from remote sellers

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Governance of Agreement

- Governing Board administers Agreement
 - Includes representatives of each member state
 - DOR Secretary represents NC
- Executive Committee and Executive Director
- State and Local Advisory Council
 - NC League of Municipalities represented
- Business Advisory Council

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NC's Experience

- Collection of over \$46.5 million through voluntary compliance since joining
- Numerous legislative changes since 2000 to conform to the Agreement
- Numerous administrative changes at DOR since 2000 to conform to the Agreement

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Simplicity Among States

- Uniform definitions
- Uniform sourcing
- Uniform rounding method
- Uniform treatment of bad debts
- Uniform sales tax holiday provisions
- Uniform returns and remittance processes

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Uniform Definitions

- Library of Definitions
 - Administrative definitions for core terms, such as tangible personal property and sales price
 - Product definitions used in tax imposition or exemptions
 - Sales tax holiday definitions
- If Agreement defines a term, a state must use a definition that is substantially the same
- Exemptions for products cannot split product definition unless Agreement authorizes the "carve-out"
 - Food, clothing, and drugs and other health-care items

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Uniform Sourcing

- Sourcing determines the jurisdiction to which tax is attributable
- Destination sourcing, as opposed to origin sourcing, is the general rule – where a good or service is received
- Special rules for leases and rentals, telecommunications service, ancillary service, direct mail, and florist wire sales
- Effective January 1, 2010, states have origin-based sourcing option for intrastate sales the purchaser does not receive at the seller's business location

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Uniform Sales Tax Holiday Provisions

- Exempt items must be defined by Agreement
- Exemptions apply to both State and local tax
- Can use price thresholds and exempt items priced below the threshold
- Must follow procedures for layaways, rain checks, exchanges, back orders, and determining time of holiday

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Exceptions to Agreement

- Vending machine sales
- Motor vehicles, aircraft, watercraft
- Modular homes, manufactured homes, mobile homes
- Electricity, piped natural or artificial gas, or other heating fuels delivered by the seller

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Simplicity Within Each State

- Uniform State and local base
- One State rate, with two general exceptions
- One rate per local jurisdiction
- No caps and thresholds

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Uniform State and Local Base


- Items in State Base must be in local base
- Food
 - Not in every local sales tax
 - Administered as if it were a State tax
 - Distributed among local jurisdictions based on a formula
- Exception when federal law prohibits local tax – such as Direct TV

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One Rate Per Jurisdiction




- NC has 103 jurisdictions that can impose a tax
 - The State, 100 counties, and two transportation authorities
- One State rate unless:
 - Second rate is on food or drugs and is the same if on both
 - Federal law prohibits imposition of local tax and additional rate achieves tax parity for similar products
- Single local sales and use tax rate

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Simplicity in Filing Return and Paying Tax

- State level administration of tax
- State responsible for electronic, downloadable databases of jurisdiction boundaries and tax rates
- Central, electronic registration for all states
- Simple electronic return and electronic payment

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Simplicity Through Use of Technology

- Certified service provider – agent for the seller
- Certified automated system - software used by seller

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Federal Legislation

- Main Street Fairness Act expected to be introduced this session
- Senator Mike Enzi (R-WY) and Congressman Bill Delahunt (D) Maine
- Compensation issue under review

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Resources

- <http://www.streamlinedsalestax.org/>
- <http://www.dornco.com/taxes/sales/streamlined.html>

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