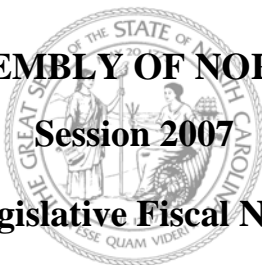


GENERAL ASSEMBLY OF NORTH CAROLINA



Session 2007

Legislative Fiscal Note

BILL NUMBER: Senate Bill 1629 (First Edition)

SHORT TITLE: Limited Sales Tax Exemption for Baked Goods

SPONSOR(S): Senator Hoyle

FISCAL IMPACT					
	Yes (X)	No ()	No Estimate Available ()		
	(In millions)				
	<u>FY 2008-09</u>	<u>FY 2009-10</u>	<u>FY 2010-11</u>	<u>FY 2011-12</u>	<u>FY 2012-13</u>
REVENUES					
General Fund Impact	(15.1)				
Local Impact	(1.5)				
EXPENDITURES					
POSITIONS (cumulative):					
PRINCIPAL DEPARTMENT(S) & PROGRAM(S) AFFECTED: North Carolina Department of Revenue					
EFFECTIVE DATE: April 1, 2003 thru March 1, 2006					

BILL SUMMARY: Under current law, “prepared food” is subject to both state and local sales tax, while “food” is subject only to a two percent local tax. Certain bakery items fall within the definition of “prepared food” if they are sold in a heated state, heated by the retailer, or if the item consists of two or more foods mixed or combined by the retailer for sale as a single item. This legislation excludes certain bakery items from the Streamlined Sales Tax Agreement (SSTA) category of prepared food and state sales and use taxes. The bill becomes effective April 1, 2003 and applies to sales made on or after that date and before March 1, 2006.

ASSUMPTIONS AND METHODOLOGY:

In 2001, the General Assembly, in an attempt to conform to the requirements of the Streamlined Sales Tax Agreement (SSTA), redefined food and created a new category of food – prepared food. The General Assembly determined that all prepared food is taxable by the state in 2003. In conjunction to the state sales tax, local jurisdictions began applying an additional ½ cent sales tax to prepared food under Article 44 of the North Carolina Tax Code. This ½ cent local levy expires October 2009.

Based on the definition in the current law, bread and other items sold in a bakery or in the bakery portion of a grocery or discount store are considered prepared food, not food, and therefore not tax exempt though sold for off premises consumption. Retailers, however, believe the definition of prepared food is unclear. As a result, some retailers have been applying state tax to these items while others have not. This legislation clarifies that bakery items are exempt when they are sold without utensils.

An exemption for bakery items, as defined under the SSTA, would affect several types of retailers; businesses classified as bakeries by the North Carolina Department of Revenue, and retailers not classified as bakeries by the Department but who derive some portion of their profits from the sale of bakery items, primarily grocery stores, supermarkets, and other retailers who prepare bakery items on-premises for retail sale.

Bakeries

Between 2003 and 2006, the Department of Revenue reported a total of \$13.0 million in state sales and use taxes and an additional \$1.4 million in local taxes remitted by bakeries. Under this bill, bakeries and pastry shops would be refunded the full \$14.4 million paid during the 2003-2006 period.

Grocery stores and supermarkets

The Department also reported \$703 million in state tax collections and \$71 million in local tax collections from grocery stores and similar retailers during the three year period for which this bill is effective. A portion of gross collections from grocery stores are associated with the sale of bakery items. Currently, many items in grocery stores are not subject to state tax and the Department of Revenue indicated that most major grocery stores have been in compliance with the 2003 sales tax change ("prepared food") that brought prepared bakery items under the state sales tax.

The Department of Revenue does not have detailed data on the composition of gross revenues from grocery stores, so an alternative method of estimation was necessary for this fiscal note. To estimate the impact of qualifying bakery items sold by grocery stores and supermarkets, Fiscal Research computed the percent of sales of bakery items as 0.3% of all grocery store sales based on information from the 2002 Economic Census.¹ Using this assumption, the amount of sales tax revenue repaid to grocery stores due to the exemption of prepared bakery items would be \$2.3 million dollars.

Other retailers selling bakery items

Some retailers selling bakery items that qualify for this exemption, such as convenience stores, general stores, and drug and medical stores, do not fit the category of bakery (as defined by the Department of Revenue) or grocery store/supermarket. Since the Streamlined Sales & Use Tax Agreement specifies that bakery items that are sold for home consumption are exempt but not bakery items intended for on-premises consumption (i.e., the retailer provides eating utensils),

¹Source: U.S. Census Bureau, 2002 Economic Census, Retail Trade by Sub Sector. Available at: <http://www.census.gov/econ/census02/>. According to the 2002 Economic Census, retail sales by food and beverage stores totaled \$463 million dollars with 0.31% of the sales, or one million dollars, being generated by baked goods stores.

there is some question as to whether or not retailers of this sort would qualify for the exemption. Since Fiscal Research has no data on which to base an estimate for this type of retailer, an estimate using the loss due to grocery stores and supermarkets has been calculated.

SOURCES OF DATA:

U.S. Census Bureau, 2002 Economic Census
 North Carolina Department of Revenue

TECHNICAL CONSIDERATIONS:

Table 1 includes more information on the methodology used to compute state and local tax refunds due to grocery stores and bakeries.

Table 1: Sales Tax Paid for Baked Goods Sold at Bakeries, Groceries, and Meat Markets, FY2003-04 to FY2005-06 (in millions)				
	FY 2003-04*	FY2004-05	FY2005-06*	Total
General Fund Impact	(6.2)	(5.1)	(3.8)	(15.1)
Local Revenue	(0.7)	(0.6)	(0.3)	(1.6)
State and Local Revenue	(6.9)	(5.7)	(4.1)	(16.7)

*This bill becomes effective April 1, 2003 and applies to sales made on or after that date. This act is repealed effective March 1, 2006. FY2003-04 includes three additional months of compensation from the last three months of FY02-03. FY06-07 is prorated to represent the first eight months of the fiscal year thru March 1, 2006.

FISCAL RESEARCH DIVISION: (919) 733-4910

PREPARED BY: Sandra D. Johnson

APPROVED BY

Lynn Muchmore, Director
 Fiscal Research Division

DATE: May 19, 2008



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