

# GENERAL ASSEMBLY OF NORTH CAROLINA



Session 2007

## Legislative Fiscal Note

**BILL NUMBER:** Senate Bill 1630 (First Edition)

**SHORT TITLE:** Sales and Use Tax Exemption for Baked Goods.

**SPONSOR(S):** Senator Hoyle

<b>FISCAL IMPACT</b>					
	<b>Yes (X)</b>	<b>No ( )</b>	<b>No Estimate Available ( )</b>		
	<b>(In millions)</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><u>FY 2012-13</u></b>
<b>REVENUES</b>					
<b>General Fund Impact</b>	<b>(7.89)</b>	<b>(8.49)</b>	<b>(8.78)</b>	<b>(8.95)</b>	<b>(9.13)</b>
<b>Local Impact</b>	<b>(0.56)</b>	<b>(0.11)</b>	<b>(0)</b>	<b>(0)</b>	<b>(0)</b>
<b>EXPENDITURES</b>					
<b>POSITIONS (cumulative):</b>					
<b>PRINCIPAL DEPARTMENT(S) &amp; PROGRAM(S) AFFECTED:</b> North Carolina Department of Revenue					
<b>EFFECTIVE DATE:</b> July 1, 2008					

### **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 July 1, 2008 and applies to sales made on or after that date.

### **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 in 2003 determined that all prepared food is taxable by the state. 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 in October 2009.

Based on the definition in the bill, bread and other items sold in a bakery or in the bakery portion of a grocery or discount store could be considered prepared food, not food, and therefore not tax exempt though sold for off premises consumption. However, retailers 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

The Department of Revenue reported \$ 6.4 million in state and \$0.7 million in local sales and use tax collections from businesses identifying themselves as bakeries during FY 2006-07. Under this bill, the majority of those sales would be tax exempt.

#### Grocery stores and supermarkets

The Department also reported \$292 million in state and local sales and use tax collections from grocery stores and similar retailers during the 2006-07 fiscal year. A portion of these gross collections 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 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.<sup>1</sup> Using this assumption, the amount of sales tax revenue paid by North Carolina grocery stores associated with the sale of bakery items would be \$0.9 million dollars in FY06-07.

#### Other retailers selling bakery items

Some retailers selling bakery items that would 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 may be exempt but not

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<sup>1</sup>Source: 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.

bakery items intended for on-premises consumption (i.e., the retailer provides eating utensils), 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, a conservative estimate of the loss due to grocery stores and supermarkets has been used.

**SOURCES OF DATA:**

U.S. Census Bureau, 2002 Economic Census  
North Carolina Department of Revenue  
Moody's Economy.com

**TECHNICAL CONSIDERATIONS:**

Fiscal Research applied a two percent annual inflation rate as noted by Moody's Economy.com to the FY06-07 tax collections from bakeries and grocery stores to calculate the fiscal impact of S1630.

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