SENATE BILL 126: Change the LOST Adjustment Factor.

2017-2018 General Assembly

Committee:	Senate Rules and Operations of the Senate	**Date:**	April 26, 2017
Introduced by:	Sen. Brown	**Prepared by:**	Cindy Avrette
Analysis of:	First Edition		Staff Attorney

OVERVIEW:* *Senate Bill 126*[1] *would replace the numerous local option sales tax (LOST) percentage adjustment factors with three factors that would be assigned to counties annually based on the county's economic development tier. The bill would become effective July 1, 2017, and apply to local option sales taxes collected on or after that date.

CURRENT LAW: Effective March 1, 1988, the LOST revenue allocated on a per capita basis has been adjusted by the percentage factors in G.S. 105-486(b).[2] Each county is assigned an adjustment factor. The adjustment factors range from 1.49, meaning that county receives 149% of the sales tax revenue that would be allocated to it under a strict per capita distribution; to .81, meaning the county receives 81% of the revenue that would otherwise be allocated to it under a strict per capita distribution. If, after applying the adjustment factors, the resulting total of the amounts allocated is greater or lesser than the net proceeds to be distributed, the amount allocated to each county is proportionally adjusted to eliminate the excess or shortage.

The bill does not affect the G.S. 105-524 adjustment factors enacted in 2015 and used to provide an additional distribution from LOST revenue to counties to address sales tax leakage that results from the different revenue-raising capacity of LOST in the taxing jurisdictions. The history of the 105-486(b) ajustment factors is included in the **BACKGROUND** section of this summary.

BILL ANALYSIS: Senate Bill 126 does not repeal the adjustments factors, but it does change them. In place of a specified percentage for each county, it adjusts the per capita distribution based on a county's development tier under G.S. 143B-437.08: tier one counties would receive a distribution equal to 110% of what they would otherwise receive under a per capita distribution formula and tier three counties would receive a distribution equal to 90% of what they would otherwise receive under a per capita distribution formula. Tier two counties would receive a per capita distribution amount with no adjustments.

The State has used the tier structure for economic development purposes since the late 1990s. The Department of Commerce annually ranks the counties into one of three tiers based upon statutory criteria.[3] The statutory criteria is based on four development factors;[4] however, irrespective of the composite score based on the four development factors, certain statutory adjustment factors modify the tier ranking of a county based, among other things, on the population, multi-jurisdiction cooperation,

[1] As introduced, this bill was identical to H522, as introduced by Rep. Lewis, which is currently in House Finance.
[2] Today, the adjustment factors are applied to the LOST revenue distributed under Article 40 and to 1-cent of the sales tax on food.
[3] 2017 Tier Designations
[4] Median household income, unemployment, percentage growth in population, and adjusted assessed property value per capita.

and population + poverty rate considerations.[5] There are 40 tier one counties, 40 tier two counties, and 20 tier three counties.

EFFECTIVE DATE: This bill would become effective July 1, 2017, and apply to LOST collected on or after that date and distributed to counties and cities on or after September 1, 2017.

BACKGROUND: For sales and use tax revenue distributed on a point of origin basis, it matters where the sale occurs. The statute dictates the rules to be followed when sourcing a sale. Prior to March 1, 1988, the LOST authorizations effectively used a destination-based sourcing rule, meaning the sale occurred in the county where the purchaser received the tangible personal property, because the local authorizing statutes did not apply to sales where the tangible personal property was sold in one county and delivered to a purchaser in another county. Instead, the purchaser was liable for use tax levied by the purchaser's county. In practice, this use tax was often not collected. Beginning March 1, 1988, the General Assembly closed this loophole by providing that the situs of a sale was considered to be the county of the retailer's place of business. The change in situs from the purchaser's county to the seller's county would have resulted in a shift of revenues between certain counties. To hold counties harmless, the General Assembly amended the distribution formula for the two half-cent taxes[6] distributed on a per capita basis by adjusting the county's allocation up or down by a percentage before distribution. The percentages in the formula have not changed since the formula was enacted in 1987.

In S.L. 2001-347, the General Assembly changed the sourcing rule from point-of-sale to destination sourcing to comply with the Streamlined Sales Tax Agreement, a multi-state agreement developed to simplify the administration of the sale tax among states. Effectively, this change returned the LOST sourcing rule to the place it was prior to the enactment of the adjustment factors. However, the act did not repeal the adjustment factors. The correlation between the adjustment factors and the local sourcing rule was not raised in the discussions of this act; the act made many changes to the administration of the State's sales tax laws to conform to provisions in the Agreement. Arguably, the purpose for the adjustment factors no longer exists since the sourcing rule is destination sourcing.

---

[5] Senate Bill 660 would modify the criteria used to determine tier designations.

[6] Originally the adjustment factors applied to LOST authorized under Articles 40 and 42. The distribution of revenue under Article 42 has subsequently been changed from a per capita distribution to a point of origin distribution; the adjustment factors no longer apply to the distributions under Article 42.