DEPARTMENT OF TAXATION
2001 Fiscal Impact Statement

1.Patron: Day

2. Bill No: HB 2242

House of Origin:
X **Introduced**
____ **Substitute**
____ **Engrossed**

3. Committee: House Finance

4. Title: Retail Sales and Use Tax: Food Tax Reduction Program

Second House:
____ **In Committee**
____ **Substitute**
____ **Enrolled**

5. Summary/Purpose:

This bill would repeal the current schedule for reducing the state sales and use tax rate on food for human consumption and would provide a total exemption from the state and local sales and use taxes on food purchased for human consumption, effective July 1, 2001.

This bill requires that foregone revenues to the Transportation Trust Fund (TTF), to the localities for educational purposes, and the local option sales tax revenues would continue to be funded from other General Fund (GF) revenues. The distributions to the TTF and the localities must total an amount equal to 2½% of the sales tax on food purchased for human consumption. The distributions would be indexed to changes in the Consumer Price Index. The amounts allocated to the localities would be distributed in a manner intended to preserve the current timing of cash flows to the localities.

Under this bill, "food purchased for human consumption" means food as defined in the Food Stamp Act of 1977, 7 U.S.C. § 2012, except for seeds and plants which produce food for human consumption.

6. Fiscal Impact Estimates are: Tentative. (See Line 8).

6a. Expenditure Impact:

Fiscal Year	***Dollars***	***Fund***
2000-01	$48,000	GF
2001-02	$76,400	GF

2002-03	$2,000	GF

6b. Revenue Impact: (See Line 8).

Total Effect on State Funds – HB 2242
(millions of dollars)

	FY2002	**FY 2003**
Impact on GF Revenue	($208.5)	($232.8)
Additional Appropriations:*		
Local Option	($78.3)	($96.2)
TTF	($43.1)	($48.1)
Total Effect on State Funds	**($329.9)**	**($377.1)**

*Local option and TTF revenue losses due to sales tax on the food reduction would be offset by mandated new state appropriations. Although an appropriation to localities for education purposes is also required under this bill, it does not represent a net increase in appropriations from current law.

7. Budget amendment necessary: Yes.
Page 1, Revenue estimates
Items 279 and 281, Department of Taxation
Budget aid to localities.
GF appropriation to TTF.

8. Fiscal implications:

Administrative

The department would incur administrative costs of $48,000 in fiscal year 2001 and $76,400 in fiscal year 2002 for forms development, printing, and postage.

While this bill does have costs associated with systems development, these cannot be ascertained at this time. The cost for implementing a **single** piece of legislation cannot be calculated precisely due to economies of scale. The actual cost to implement **all** legislation enacted during a given session will more than likely be less than the sum of the costs attributed to individual bills. Further, the ability to accurately predict costs is complicated because TAX is replacing its current database system. As a result, legislative changes may need to be made to both the current and the future system, depending on the effective date. Therefore, TAX is not providing specific systems costs for this bill, but will calculate the total for all tax bills once they have been acted upon favorably in both houses and prior to the conference committee report.

Revenue

This bill would eliminate the retail sales and use tax on food purchased for human consumption. This would affect: (1) revenues dedicated to the GF for unrestricted use by the Commonwealth, (2) revenues returned to the localities for educational purposes, (3) TTF revenues, and (4) local option sales tax revenues. It is estimated that this bill would have a negative impact on GF revenues of $208.5 million in fiscal year 2002 and $232.8 million in fiscal year 2003.

This bill also requires that the TTF and the localities be compensated for foregone revenues resulting from the elimination of the sales and use tax on food for human consumption. This would require new GF appropriations of $121.4 million in fiscal year 2002 and $144.3 million in fiscal year 2003. This will have the effect of reducing funds available for other appropriations. Therefore, this bill would have a total negative impact on the GF revenues and funds available for other appropriations of $329.9 million in fiscal year 2002 and $377.1 million in fiscal year 2003.

The GF appropriation estimates are indexed to the Consumer Price Index as required in the bill. The Consumer Price Index is a federal tool used to monitor cost increases in consumable goods.

The revenue estimates assume the deduction of the dealer's discount in computing the distributions to the localities for educational purposes. The dealer's discount is a deduction from the state sales tax by dealers for timely filing of the tax.

9. Specific agency or political subdivisions affected:

Department of Taxation

10. Technical amendment necessary: Yes.

The bill as drafted prescribes that the distributions to the TTF and the localities be computed based on 2½% of the sales and use tax on food for human consumption. If the intent is to provide compensation to the TTF and the localities in an amount equal to lost revenues, the bill should be amended to reflect 2½% of total taxable purchases of food for human consumption. To accomplish this, the following technical amendment is recommended:

Page 1, Line 19, after: equal to
Strike: a two and one-half percent sales and use tax on
Insert: two and one-half percent of total taxable purchases of

11. Other comments:

Food Stamp Definition

Under this bill, “food purchased for human consumption” means food as defined under the federal Food Stamp Program. This is the same definition utilized under the current Food Tax Reduction Program. The definition is broad and includes any food or food product for home consumption, except alcoholic beverages, tobacco, and hot foods or hot food products ready for immediate consumption. Hot meals for immediate consumption are generally excluded from the food stamp definition.

In utilizing the food stamp definition, the reduced sales tax rate and the exemption would apply to purchases of a wide variety of grocery and staple items such as meats, fruits and vegetables, cereals, beverages, snack and bakery foods, and dietary and health foods. In addition, cold prepared foods and beverages packaged for home consumption qualify as “food purchased for human consumption” under the federal definition.

Allocation of Revenues from Sales of Food

Under the current Food Tax Reduction Program, the revenue generated from the 4.0% sales and use tax is allocated to the GF, the TTF, and the localities. The GF currently retains a 1.5% share of the tax revenues for unrestricted use by the Commonwealth. An additional 1% of the tax revenue goes into the GF for educational purposes and is returned to the localities based on school-age population. The TTF receives 0.5% of the sales tax revenues and the remaining 1% represents the local option sales tax revenues. This bill would compensate the TTF and the localities in an amount equal to 2.5% of the sales and use tax revenues.

Appropriation of Foregone Revenues

This bill provides that upon elimination of the sales tax, foregone revenues allocated to localities for educational purposes, the TTF, and the local option sales tax revenues would be funded from other state revenues. This would require an appropriation in the amount of the foregone revenues.

This would also require that estimates of food sales by locality be made for fiscal year 2001 and beyond. Such estimates become increasingly difficult in future years and must rely on historical growth rates which may not correctly reflect growth taking place in the locality.

Local Option Sales Tax Distributions

This bill requires that the distribution to localities for compensation of local option sales tax revenues be computed in amounts proportionate to each locality's share of local sales tax money credited to the special fund for the collection of local sales taxes.

This bill requires that for each fiscal year beginning after June 30, 2002, the formula for computing the distribution to reimburse the localities would be based on the latest actual local sales tax collections for the most recently completed fiscal year. After July 1, 2001, the local sales tax base will not contain food sales. Therefore, the distribution amount of local revenues will vary considerably from the previous years as the local tax base in the prior years includes food sales. This would be particularly true for rural areas in which food sales tend to be a high percentage of the total local taxable sales as opposed to a large urban area in which food is a relatively small percentage of the taxable sales base.

Other States' Food Exemptions

Generally

Of the 45 states that impose sales and use taxes, 31 currently provide an exemption of some type for food for human consumption. These exemptions range from full exemptions, some with phase-out provisions, to partial exemptions applying reduced rates on food. Some states fully tax food sales and allow an income tax credit or grant a refund for sales and use tax paid on food. The most recent additions are Louisiana, North Carolina and Virginia. Effective July 1, 2000, Louisiana provides a full exemption for food sales, instead of the prior reduced tax rate. North Carolina provides an exemption from the state sales and use tax on food for human consumption. Virginia currently provides a reduced sales and use tax rate on food for human consumption. (Source: Survey by Federation of Tax Administrators.)

Border States

- Maryland, Kentucky, and the District of Columbia exempt food for human consumption.
    - Maryland follows the food stamp definition of "food" with exceptions for soft drinks or carbonated beverages, candy and confectionery. These items, however, are exempt when sold by grocers and markets and through vending machines. Maryland also exempts milk, fresh fruit, fresh vegetables and yogurt sold through vending machines. Maryland taxes all prepared food consumed on or off the premises.

- Kentucky does <u>not</u> follow the food stamp definition of “food” but instead exempts products deemed to be a “nutritional necessity.” Taxable items include candy, confectionery, chewing gum, soft drinks, sodas and similar beverages, water, meals served on or off the premises, and food sold through vending machines.

- The District of Columbia exempts all food and drink with the exception of food or drink sold through vending machines or prepared for immediate consumption, and snack food.

- Tennessee and West Virginia currently impose the sales and use tax on food and food products.

<u>Other Legislation</u>

House Bill 1750 would amend the definition of food for purposes of applying the reduced sales tax rate under the Food Tax Reduction Program.

SB 783 would eliminate the revenue growth safeguard provided in the Food Tax Reduction Program.

SB 1264 is identical to this bill.

cc: Secretary of Finance

Date: 1/21/01/VHM
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