

# Statement of Estimated State Revenue Impact

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**Date:** May 31, 2011 (As amended on May 26, 2011 by the Senate)

**Bill Number:** S.B. 36

**Authors:** McConnell, McGill, Setzler, and Ford

**Committee Requesting Impact:** House of Representatives

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## Bill Summary

To amend Act 99 of 2007, relating to the sales tax exemption for durable medical equipment and supplies, by repealing Sections 1B and 1C, which state that the sales tax rate on durable medical equipment is five and one-half percent subject to further reduction based on General Fund revenue growth.

## REVENUE IMPACT <sup>1</sup>

Section 1 of this bill, as amended, is expected to reduce sales and use tax revenue by an estimated \$817,936 in FY2011-12, by an additional \$715,694 in FY2012-13, and by an additional \$715,694 in FY2013-14 for a total impact of \$2,249,324 when fully implemented in FY2013-14. Section 2 of this bill, as amended, is expected to increase sales and use tax revenue by an estimated \$500,000 in FY2011-12. Sections 3 and 4 of this bill, as amended, are expected to have no impact on general fund revenue in FY2011-12. In total, this bill, as amended, is expected to reduce sales and use tax revenue by an estimated \$317,936 in FY2011-12, by an additional \$715,694 in FY2012-13, and by an additional \$715,694 in FY2013-14 for a total impact of \$1,749,324 when fully implemented in FY2013-14. Of this amount, General Fund sales and use tax revenue would be reduced by \$1,166,216, Education Improvement Act funds would be reduced by \$291,554, and the Homestead Exemption Fund would be reduced by \$291,554 in FY2011-12.

## Explanation of Amendment (May 26, 2011) – By the Senate

**Section 3.** This amended section would add Section 12-36-2691 to apply to a taxpayer that meets the following criterion: (1) places a distribution facility in service after December 31, 2010 and before January 1, 2013; (2) makes a capital investment of at least \$125,000,000 after December 31, 2010 and before December 31, 2013; (3) creates at least 2,000 full-time jobs, including a comprehensive health plan, after December 31, 2010 and before December 31, 2013; and (4) maintains at least 1,500 full-time jobs with a comprehensive health plan for those employees until January 1, 2016. Section 12-36-2691 would no longer apply on the earlier of January 1, 2016, when the taxpayer fails to meet any of the criteria listed above, or on the effective date of a law enacted by the U.S. Congress that allows a state to collect sales tax from a taxpayer irrespective of a substantial nexus with that state. This section would also require the seller of a product through an Internet website to notify the purchaser in a confirmation email that the purchaser may owe South Carolina use tax on the total sales price of the transaction, and include a link to the Department of Revenue that allows for the remittance of the use tax. The purchaser of the item may either remit the use tax to the Department of Revenue at the time of purchase or may report and pay the use tax on the purchaser's South Carolina income tax form. By February 1<sup>st</sup> of each year, the seller would also be required to provide to each purchaser of products delivered in South Carolina a statement of total sales made to the purchaser during the preceding calendar year. The statement would serve as notification that use tax is due the Department of Revenue on the total sales price of products purchased on-line during the past year. This amended section is not expected to impact General Fund revenue in FY2011-12.

**Section 4.** This amended section would add Section 12-36-2692 to require each person to whom Section 12-36-2691 applies to provide readily visible notification on invoices or other similar documentation that use tax is imposed on its sales and must be paid by the purchaser. The person

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would be deemed compliant if a prominent linking notice on its invoices or other similar documentation that directs its customers to information regarding the customer's use tax responsibilities is provided. This amended section is not expected to impact General Fund revenue in FY2011-12.

## **Explanation of Amendment (May 18, 2011) – By the House**

**Section 1:** This section of the bill, as amended, would reduce the sales and use tax on the sale of durable medical equipment (DME) paid directly by funds under the Medicare and Medicaid programs from five and one-half percent to three and one-half percent starting on July 1, 2011. The sales tax would be reduced from three and one-half percent to one and three-quarters percent effective July 1, 2012. DME paid directly by funds under the Medicare and Medicaid programs would then be fully exempt from the sales and use tax starting on July 1, 2013. This amendment would also repeal Section 1C which triggers the incremental reduction in the sales tax rate on DME based on General Fund revenue growth. Based upon collections of the five and one-half percent sales tax on DME in FY09-10, we estimate that this amendment will reduce General Fund sales tax revenue by \$817,936 in FY2011-12, by an additional \$715,694 in FY2012-13, and by an additional \$715,694 in FY2013-14 for a total impact of \$2,249,324 when fully implemented in FY2013-14. Of this total amount, General Fund sales and use tax revenue would be reduced by \$1,499,550, Education Improvement Act funds would be reduced by \$374,887, and the Homestead Exemption Fund would be reduced by \$374,887 when fully implemented in FY2013-14.

**Section 4:** Nexus is considered to be a situation in which a business has a presence in a state where the selling of goods and services takes place and is responsible for remitting taxes for the privilege of doing business in the state. This bill would add Section 12-36-2691 to state that owning or utilizing a distribution facility within South Carolina is not considered in determining whether a taxpayer has physical presence in South Carolina sufficient to establish nexus with South Carolina for sales and use tax purposes. As provided in this section, a "distribution facility" means an establishment where only shipments of tangible personal property are processed for delivery to customers and no retail sales are made. This section only applies to a taxpayer that meets the following criterion: places a distribution facility in service after December 31, 2010 and before December 31, 2013; makes a capital investment of at least \$125,000,000 after December 31, 2010 and before December 31, 2013; and creates at least 2,000 full-time jobs, including a comprehensive health plan, after December 31, 2010 and before December 31, 2013. There is currently no facility within this State that meets this criterion. This provision would expire on January 1, 2016, or if the company fails to meet the minimum capital investment requirement and the full-time job threshold. A company meeting these requirements would be eligible for a jobs tax credit for each new, full-time job and also be able to withhold a percentage of each new job's individual income tax withholdings through job development fees. These income tax credits and fees would be greater than the income tax the state would receive for each job. Also, because a distribution facility meeting these criteria would not have nexus in the state under this section, there would be no basis for the collection of sales taxes on the purchases of goods sold through the establishment. Since the enactment of this bill would not change the collection of revenues, it is not expected to impact General Fund revenue in FY2011-12. Except where otherwise provided, this act takes effect upon approval by the Governor.

## **Explanation of Amendment (May 5, 2011) – By the House Revenue Policy Legislative Subcommittee**

**Section 1:** This section would amend Act 99 of 2007 by repealing Section 1B and 1C which states that the sales tax rate for durable medical equipment paid directly by funds under the Medicare and Medicaid programs is five and one-half percent subject to further reduction based on General Fund revenue growth. The repeal of these sections would fully exempt durable medical equipment paid directly by funds under the Medicare and Medicaid programs from sales tax. Currently, the sales tax rate for durable medical equipment is five and one-half percent. Further incremental reduction of this

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rate has not occurred because forecasted General Fund revenues have not grown at the required five percent rate. This section of the bill would take effect July 1, 2011. Based upon collections of the five and one-half percent sales tax on durable medical equipment in FY09-10, we estimate that fully exempting the sales tax from sales of durable medical equipment is expected to reduce General Fund sales tax revenue by \$2,249,324 in FY2011-12.

**Section 2:** A warranty is given to the purchaser of a product by a manufacturer or provider of a service with the understanding that the manufacturer or provider will replace or repair a defective product or make good an ineffective service within a predetermined span of time. An extended warranty is similar to insurance for the purchased product and can be offered by the product's manufacturer, the retailer, or a third-party warranty provider. The most common products covered by extended warranties are automobiles, electronics, appliances, and homes. Currently, sales and use tax is charged on the sale of a warranty or extended warranty on a product sold at the time a product is purchased and also if an extended warranty is purchased at a later date after the product is first purchased. If a problem develops with the product and the product is sent back to the manufacturer for repair, the parts withdrawn from inventory and used to fix the defective product would not be subject to a sales tax. Under this bill, sales and use tax would still be charged on the sale of a warranty or extended warranty on a product at the time of purchase, however, there would be no sales tax charged on the warranty or extended warranty if it is purchased at a later date after the product is first sold. If a product becomes defective during the warranty period and is sent back to the manufacturer for repair, the parts withdrawn from inventory and used to fix the defective product would be subject to a sales tax.

This bill would amend Section 12-36-90(1)(c)(iii) – definition of gross proceeds of sales, Section 12-36-90(2)(l) – definition of gross proceeds of sales, Section 12-36-910(B) – sales tax, Section 12-36-1310(B) – use tax, and Section 12-36-2120(69) – sales and use tax exemption, to amend language not to levy sales tax on a warranty or extended warranty if the warranty is sold after the sale of the product. According to the latest data from the Federal Trade Commission and Warranty Week, a national trade newsletter for warranty management professionals, manufacturer's usually set aside funds to cover the costs to repair defective manufactured products each year. Based upon these data, we estimate that there will be net increase of sales and use tax revenue of an estimated \$500,000 in FY2011-12.

**Explanation of Amendment (March 2, 2011) – By the Senate Sales and Income Taxation Subcommittee**  
This amendment would reduce the sales and use tax on the sale of durable medical equipment (DME) paid directly by funds under the Medicare and Medicaid programs from five and one-half percent to three and one-half percent starting on July 1, 2011. The sales tax would be reduced from three and one-half percent to one percent effective July 1, 2012. DME paid directly by funds under the Medicare and Medicaid programs would then be fully exempt from the sales and use tax starting on July 1, 2013. This amendment would also repeal Section 1C which triggers the incremental reduction in the sales tax rate on DME based on General Fund revenue growth. Based upon collections of the five and one-half percent sales tax on DME in FY09-10, we estimate that this amendment will reduce General Fund sales tax revenue by \$817,936 in FY2011-12.

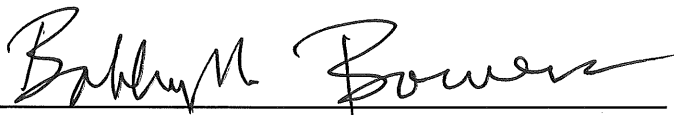
**Explanation of Bill filed January 11, 2011**

This bill will amend Act 99 of 2007 by repealing Section 1B and 1C which states that the sales tax rate for durable medical equipment paid directly by funds under the Medicare and Medicaid programs is five and one-half percent subject to further reduction based on General Fund revenue growth. The repeal of these sections would fully exempt durable medical equipment paid directly by funds under the Medicare and Medicaid programs from sales tax. Currently, the sales tax rate for durable medical

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equipment is five and one-half percent. Further incremental reduction of this rate has not occurred because forecasted General Fund revenues have not grown at the required five percent rate. Based upon collections of the five and one-half percent sales tax on durable medical equipment in FY09-10, we estimate that fully exempting the sales tax from sales of durable medical equipment is expected to reduce General Fund sales tax revenue by \$2,249,324 in FY2011-12.



Bobby M. Bowers  
Director

**Analysts:** Ball/Martin

<sup>1/</sup> This statement meets the requirement of Section 2-7-71 for a state revenue impact by the BEA, or Section 2-7-76 for a local revenue impact or Section 6-1-85(B) for an estimate of the shift in local property tax incidence by the Office of Economic Research.