
Coates' Canons Blog: How Would an Internet Sweepstakes Ban Affect City Privilege License Taxes?

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[Update: The ban on internet sweepstakes became law when Gov. Perdue signed H.B. 80 on July 20. The ban was upheld by the N.C. Supreme Court in late 2012. See this blog post for more details.]

The General Assembly moved closer to banning internet sweepstakes on Monday when the Senate voted 47-1 in favor of H.B. 80, which would make all internet sweepstakes activity illegal as of December 1, 2010. The bill now moves to the House where it may have a committee hearing today.

A number of local officials have asked how this ban would affect the privilege license taxes recently levied by many cities and towns on internet sweepstakes businesses. Existing law prohibits local taxes on illegal gambling operations, meaning that if the sweepstakes ban becomes law then municipalities could no longer levy taxes on these operations after they become subject to criminal prosecution on December 1. But what about the 2010-2011 privilege license taxes already paid by sweepstakes operators? Would a city be obligated to refund those tax payments because the state eliminated the opportunity for these businesses to operate legally?

I don't think so. In my view, a city has no obligation to refund a privilege license tax to a business that shuts its doors for any reason during the fiscal year. And even if the governing board wanted to offer refunds, I think the N.C. Constitution would prohibit them unless the ordinance that authorized the tax included a refund provision.

The obligation to pay a local privilege license tax is triggered by the operation of a business at any point during the tax year. If a business is in operation on the first day of the tax year, it will be obligated to pay a privilege license tax for the entire year, even if it shuts its doors a month later. This is true whether the business closes because of fire damage, economic conditions, or changes in state law. The payment of a privilege license tax does not create a contract based on the taxpayer's ability to operate the business for the entire tax year.

It's true that some privilege license tax ordinances provide for reduced taxes on businesses that open in the latter portion of the tax year. But I don't know of a single privilege license tax ordinance that mandates refunds to businesses that are open in the first part of the tax year but close before the tax year ends. In fact, the widely used model ordinance created by my former colleagues Bill Campbell and David Lawrence includes a provision that explicitly *prohibits* refunds for businesses that close for any reason during the tax year.

The only situation in which the closing of a business could justify a partial refund is where the tax is based on gross receipts. If a new business pays a privilege license tax based on an estimate of its gross receipts for the coming tax year and the actual gross receipts fall short of the estimate, a refund would be due the taxpayer regardless of what caused the shortfall. But very few of the municipal privilege license taxes on sweepstakes operators that I've seen are based on gross receipts. Nearly all are flat-fee taxes, for which no refund would be required if the sweepstakes ban passes.

Assuming a city has no obligation to refund a privilege license tax, could it choose to do so anyway? I think the N.C. Constitution answers that question with an emphatic "no!"

Art. I, Sect. 32 of the Constitution bans “exclusive or separate emoluments or privileges from the community except in consideration of public services.” More simply, this section bans gifts of public money to individuals. I think providing a refund to a taxpayer who is not entitled to a refund would be one type of gift barred by the Constitution. Similarly, Art. V, Sect. 2(1) requires that taxes be used “for public purposes only,” which has been interpreted to mean that no public funds, regardless of their source, can be expended for the benefit of a particular person or interest. (See my colleague Kara Millonzi’s excellent discussion of the public purpose requirement here.)

Consider *Brown v. Richmond County*, 223 N.C. 744 (1943), in which the N.C. Supreme Court prohibited a county from continuing to pay the salary of a judge whose position had been eliminated by the General Assembly: “The defendant county is under no legal, equitable, or moral obligation to pay the amount demanded. The office held by plaintiff was abolished by the Legislature and not by the county. . . . Any attempt by [the county] to pay the salary which would have accrued had the court not been abolished would constitute a gift or gratuity.” I think that reasoning would apply equally well to a city’s voluntary payment of a refund to a sweepstakes operator put out of business by the General Assembly.

Bottom line: a ban on internet sweepstakes should not affect privilege license taxes levied on businesses that were in operation prior to the effective date of the ban. No refunds would be required or permitted unless the authorizing ordinance provided for refunds to businesses that close mid-year. And unpaid privilege license taxes for previously existing businesses would be subject to penalties and enforced collection remedies even after the ban takes effect.

For some great reporting on the proposed ban and a tour of internet sweepstakes parlors in Garner, check out two stories from WUNC’s Laura Leslie [here](#) and [here](#).

Links

- www.ncleg.net/Sessions/2009/Bills/House/PDF/H80v6.pdf
- canons.sog.unc.edu/?p=6971
- www.ncga.state.nc.us/Sessions/2009/Bills/House/PDF/H80v4.pdf
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