
Coates' Canons Blog: Local Sales and Use Tax Distributions: Where Does the Money Go?

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Article: <https://canons.sog.unc.edu/local-sales-and-use-tax-distributions-where-does-the-money-go/>

This entry was posted on January 30, 2012 and is filed under Finance & Tax, Sales & Other Local Taxes

UPDATE DECEMBER 2015: During the 2015 legislative session, the General Assembly made changes to local sales and use tax allocations. The effective date of the changes is July 1, 2016. For more information on those changes, [clickhere](#). Note that the changes are not reflected in the post below.

True or False:

Counties and municipalities always must distribute a portion of their local sales and use tax proceeds to other taxing districts (such as county and municipal service districts, rural fire protection districts, and school supplemental tax districts).

False. Counties and municipalities only must share a portion of their local sales and use tax proceeds with other taxing districts if the proceeds are distributed among the county and municipalities within the county on an *ad valorem* basis.

Local Sales and Use Tax Authorization

Local sales and use taxes are levied by counties (not municipalities). All counties are authorized to levy up to 2.25 percent in general local sales and use taxes. The 2.25 percent is comprised of four separate taxes—all counties currently levy three of the four taxes, totaling 2.0 percent. Counties received authorization for the additional 0.25 percent local sales and use tax in 2007. Before levying the additional tax, a county must hold a successful voter referendum. (To date, **23** counties have received voter approval to levy the tax.)

The four separate local sales and use taxes are allocated differently and carry different expenditure requirements. The four taxes, characterized by the articles in G.S. Chapter 105 under which they are levied, are the **Article 39 one-cent tax**, the **Article 40 half-cent tax**, the **Article 42 half-cent tax**, and the **Article 46 quarter-cent tax**.

Local Sales and Use Tax Allocation and Distribution

Each of the local sales and use taxes is collected by the state, along with the state's comparable tax. After collection costs are subtracted, the net proceeds of the Article 39, 40, 42, and 46 (if levied) taxes are allocated among the 100 counties. The net proceeds of the Articles 39, 42, and 46 taxes are returned to the county in which the goods were delivered (which is usually also the county in which the sale occurred). The net proceeds of the Article 40 tax are placed in a statewide pool and allocated among the counties on a per capita basis. (The per capita amounts due each county are adjusted under a statutory formula set out in **G.S. 105-486(b)**, which increases or reduces the actual per capita amount for each county.) Once the proceeds are allocated among the counties the proceeds of the Article 39, 40, and 42 taxes are divided among the government units (county and municipalities) in the county by one of two possible distribution formulas—per capita or *ad valorem*. **G.S. 105-472**. The county commissioners select the distribution formula and may change it in April of each year, to take effect in the ensuing fiscal year.

Ad valorem Distribution Method

Under the *ad valorem* distribution formula, the dollar amounts of *ad valorem* (property) taxes levied by the county and each municipality in the county in the preceding fiscal year are added. For purposes of this calculation, the amount of taxes levied by a county or municipality on behalf of each of its other taxing districts is included in the unit's total levy. The proportion that each unit's levy bears to the total levy of all units in the county determines the amount of local sales and use tax revenue that each unit receives. A county or municipality also must share its local sales and use tax proceeds with

the other taxing districts in the unit on a proportional basis. Examples of taxing districts include county and municipal service districts, rural fire protection districts, metropolitan water or sewer districts, hospital districts, some mosquito control districts, some sanitary districts, and supplemental school taxes levied less than countywide.

For example, if a county levies a county property tax and also levies taxes for three rural fire protection districts, the total county tax levy includes the general property tax proceeds plus the three rural fire district tax proceeds. When the county receives its share of local sales and use tax revenue, it must then allocate the proportional shares among the county and the three rural fire protection districts (according to the relative total levies). The county must use the local sales and use tax proceeds allocated to a rural fire protection district to fund fire and rescue tax services in the district.

Per Capita Distribution Method

The per capita distribution formula uses the annual population estimates of the State Department of Administration. The county's total population is added to the population of all municipalities in the county. This adjusted population figure is divided into the local sales and use tax revenue allocated to the county to determine the county's per capita local sales and use tax amount. The resultant figure is then multiplied by the population of the county and each municipality within it to determine each unit's share of the county's allocation. Under the per capita distribution method, there is no further division of local sales and use tax proceeds among local taxing districts within the unit. In other words, a county or municipality does not have to allocate a portion of the proceeds to its taxing districts.

Article 46 Tax Distribution

The proceeds of the Article 46 tax (if levied) are retained by the county only—there is no requirement and, in fact no authorization for a county to share the proceeds with other government units (or taxing districts) in the county.

Municipal Hold Harmless Distribution

As of October 1, 2009, counties must hold any municipalities incorporated as of October 1, 2008, harmless for the loss of a half-cent local sales tax (formerly the Article 44 tax). The hold harmless funds are equivalent to the proceeds a municipality receives from the Article 40 tax. This amount is adjusted by adding the resultant figure, positive or negative, of the following formula: subtract the amount determined by taking 25 percent of the amount of local sales and use tax revenue a municipality receives from the Article 39 tax from the amount determined by taking 50 percent of the amount of local sales and use tax revenue a municipality receives from the Article 40 tax. A municipality is not required to share its hold harmless funds with other taxing districts in the unit.

Earmarked Local Sales and Use Tax Proceeds

A municipality may expend its local sales and use tax proceeds for any authorized public purpose. A portion of a county's local sales tax revenue is earmarked for public school construction expenditures. Specifically, a county must allocate 60 percent of the following for public school capital outlay purposes or to retire any indebtedness incurred by the county for public school capital outlay: add the amount of revenue the county receives from the Article 42 tax *plus*, if the amount allocated to the county under G.S. 105-486 (Article 40 tax) is greater than the amount allocated to the county under G.S. 105-501(a) (Article 42 tax), the difference between the two amounts.

Links

- canons.sog.unc.edu/local-sales-and-use-tax-changes/
- www.ncacc.org/revenueoptions.html
- www.ncleg.net/EnactedLegislation/Statutes/HTML/ByArticle/Chapter_105/Article_39.html
- www.ncleg.net/EnactedLegislation/Statutes/HTML/ByArticle/Chapter_105/Article_40.html
- www.ncleg.net/EnactedLegislation/Statutes/HTML/ByArticle/Chapter_105/Article_42.html
- www.ncleg.net/EnactedLegislation/Statutes/HTML/ByArticle/Chapter_105/Article_46.html
- www.ncleg.net/EnactedLegislation/Statutes/HTML/BySection/Chapter_105/GS_105-486.html
- www.ncleg.net/EnactedLegislation/Statutes/HTML/BySection/Chapter_105/GS_105-472.html