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NORTH CAROLINA'S TAX SHIFT SAGA CONTINUES: House Tax Plan gives the wealthy a tax break while 95 percent of North Carolinians pay more *(updated)*

BY ALEXANDRA FORTER SIROTA, DIRECTOR

North Carolina's House leadership has thrown its hat into the tax shift ring with a plan that would increase the tax load on middle- and low income tax-payers while providing the wealthy and profitable corporations a tax cut. The House plan would convert North Carolina's personal income tax to a flat rate, while making North Carolina more reliant on the sales tax and raising taxes on the majority of North Carolinians. Such a proposal would weaken North Carolina's tax system and the broader economy by asking more from taxpayers who are already struggling in the current economy and by undermining the long-term ability of the state to maintain the building blocks of a strong economy, like pre-K, K-12 schools and higher education.

House Plan Centers on Unfair Tax Shift

By switching to a flat income tax rate and expanding the sales tax base to more goods and services, lawmakers would cut taxes for the state's most affluent households and shift that responsibility onto the middle class and the poor.

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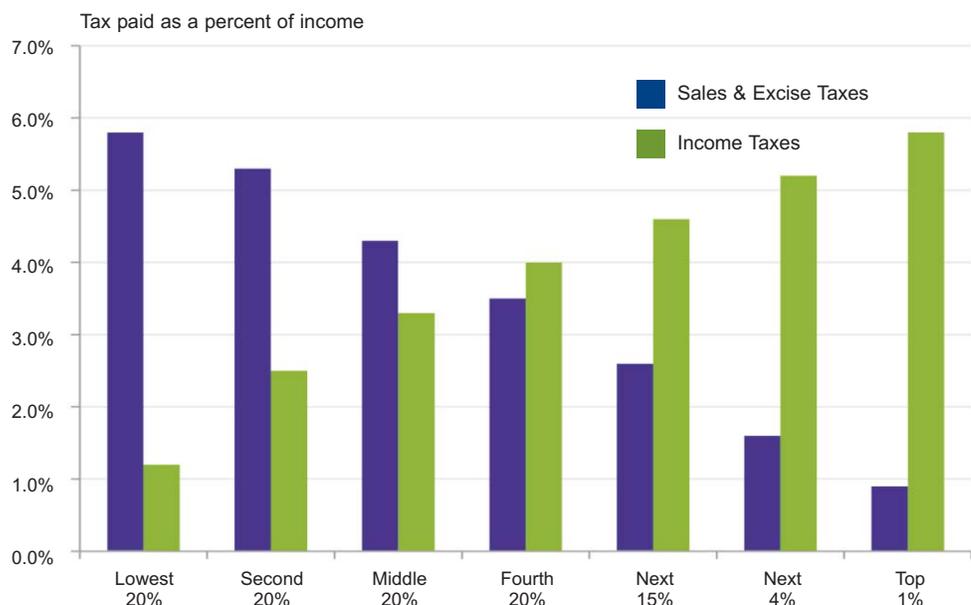
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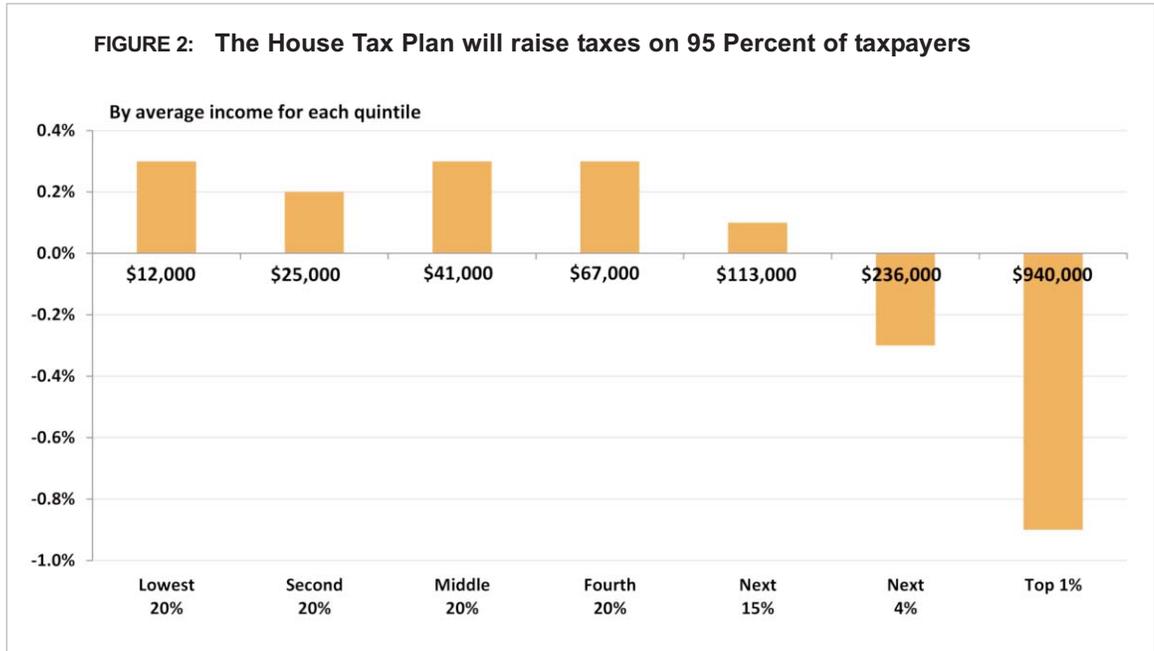
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FIGURE 1: Shift to sales tax would increase tax load on middle and low income people as evidenced by existing distribution of who pays both the sales and personal income taxes

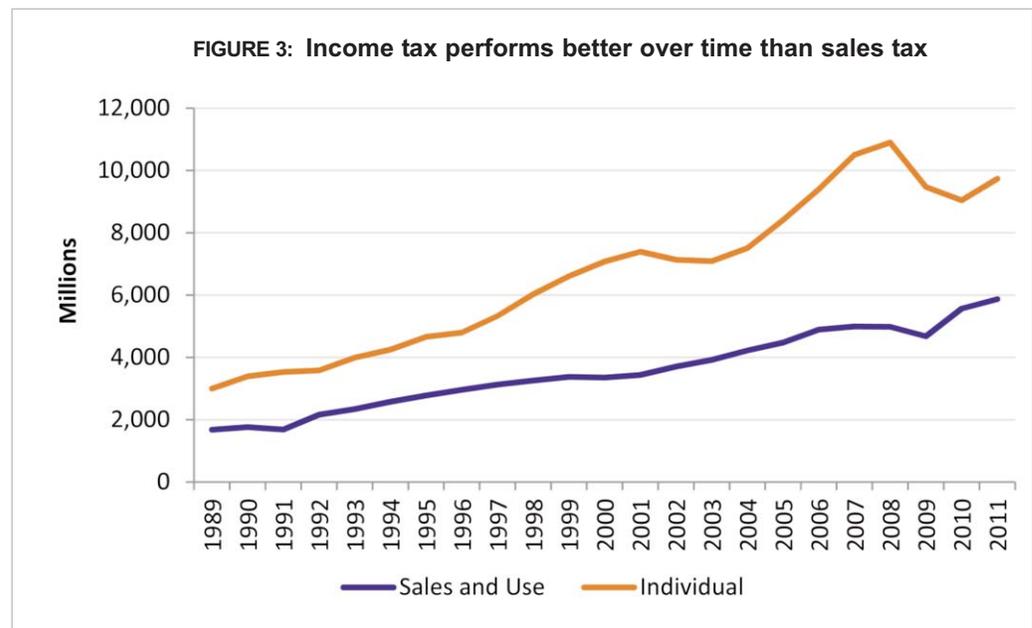




Source: Special Data Request to the Institute on Taxation and Economic Policy, June 2013

North Carolina already asks more of middle class and low-income taxpayers than its highest income households. Overall, the bottom eighty percent of North Carolina households currently pay around 9 to 10 percent of their income in state and local taxes, while the top 1 percent pay 6.5 percent. That's because the sales tax hits low-income people harder by consuming a larger share of their income because they must spend a greater portion of their income on goods subject to the sales tax compared to high-income families.¹

The state income tax is the one piece of North Carolina's tax system that can help right this wrong, if it is set up so that the wealthiest pay a greater share of their income than the lowest income households. By making the income tax a flat rate for everyone and eliminating the Earned Income



Source: North Carolina Department of Revenue, Tax Publications and Reports, State Tax Collections, 1989 - 2011

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Tax Credit, the House plan undermines this objective. More than a third, 36 percent, of the income tax cut will go to households with average income of \$940,000.

By expanding the sales tax to more services, the House tax plan will make the disparity in North Carolina's tax system worse. Overall, the large majority of North Carolina's taxpayers—95 percent—on average will see their tax bill go up while the top 5 percent see their taxes go down.

Flat Income Tax, Sales Tax Inadequate to Meet Needs

The state's ability to raise adequate resources for key investments would be weakened under the House plan because income taxes perform better than the sales tax over the long term.² A flat personal income tax grows more slowly during periods of economic growth compared to a graduated income tax that requires the wealthy to pay more. The sales tax grows even more slowly.³ A decreased reliance on the personal income tax would make it harder for tax revenue to keep pace with the economy over time, leaving North Carolina unable to maintain its most important investments, such as education.

House bill sponsors anticipate that their plan will result in \$1.2 billion less in revenue over five years but the annual revenue loss could be as high as \$573 million upon full implementation. That amount is roughly equivalent to the state's annual investment in:

- Funding for mental health, developmental disabilities and substance abuse treatment programs
- Funding for early education, child development, aging & adult services and social services
- Funding for the Judicial branch including indigent defense
- Funding for the entire Natural and Economic resource budget that includes management of state parks, infrastructure for clean water management and investments in rural and minority economic development

Eventually, Everyone will Pay

While it is clear that the richest taxpayers benefit under this plan while the low- and middle-income taxpayers will pay more, everyone will suffer over the long-term. North Carolina's schools, courts, public safety, and other key investments are important to the wealthy, too. Businesses and the wealthy rely on well-educated workers and good schools, their wealth and communities are protected by the courts and police, and their prosperity is further enhanced if North Carolina has a strong, thriving economy. All of this is compromised under the House's tax plan.

1 Sirota, Alexandra and Burch, Brenna. "Improving the Sales Tax: A Critical Step to a Modern Revenue System." The North Carolina Budget and Tax Center. September 2012.

2 Institute on Taxation and Economic Policy. "In It for the Long Haul: Why Concerns over Personal Income Tax 'Volatility' are Overblown." March 2011.

3 McNichol, Elizabeth. "Strategies to Address the State Volatility Problem: Eliminating the State Income Tax Not a Solution." Center on Budget and Policy Priorities. April 2013.

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