BTC

Analyzing the Impact of Tax Changes:

Economic Incidence Analysis a more accurate measure of how taxpayers will fare.

BUDGET & TAX CENTER FACT SHEET

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Policymakers need accurate information in order to make informed policy choices. And the general public, too, should know what is at stake when their elected officials propose tax changes. That is why it's so important to have data on how the proposed tax changes in North Carolina will impact actual taxpayers in the state.

The model used by the Budget & Tax Center was created by the Institute on Taxation and Economic Policy (ITEP), and employs methods widely considered to be the best, most comprehensive way to determine how tax changes will affect taxpayers. This type of model – known as an Economic Incidence Analysis – uses tax return data on real-world taxpayers and other economic and consumer spending data to produce the most accurate prediction. This type of model is used by the U.S. Treasury Department, the congressional Joint Committee on Taxation and the non-partisan Congressional Budget Office.

The sample taxpayer method used by North Carolina's Fiscal Research Division is another tool sometimes used to illustrate the impact of tax changes on taxpayers. However, its usefulness is very limited because it looks at how tax changes might affect hypothetical taxpayers. This method is not based on the experiences of actual taxpayers nor can its results be generalized to the population as a whole. It's nothing more than an example of a possible outcome.

Here's how these two approaches differ:

Sample Taxpayer Analysis	Economic Incidence Analysis
Uses hypothetical taxpayers. Results cannot be generalized to other taxpayers	Uses actual tax return data from a statistically valid sample of real-world taxpayers. Results are reflective of what will happen to the broader tax-paying population.
Looks at the potential impact on hypothetical taxpayers at a few specific income levels.	Uses statistical methods to see how tax proposals will impact an income group, on average. Income groupings are based on the incomes of real North Carolinians.
Looks at who is first charged the tax and uses an estimated average to assess the impact of changes. For example, it uses the average sales tax change, and applies that to its hypothetical taxpayer.	Looks at who ends up paying the tax. For example, it takes into account that businesses often pass sales tax on to consumers, and uses data on how consumers spend their money to estimate the impact of the sales tax changes on actual taxpayers.

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