

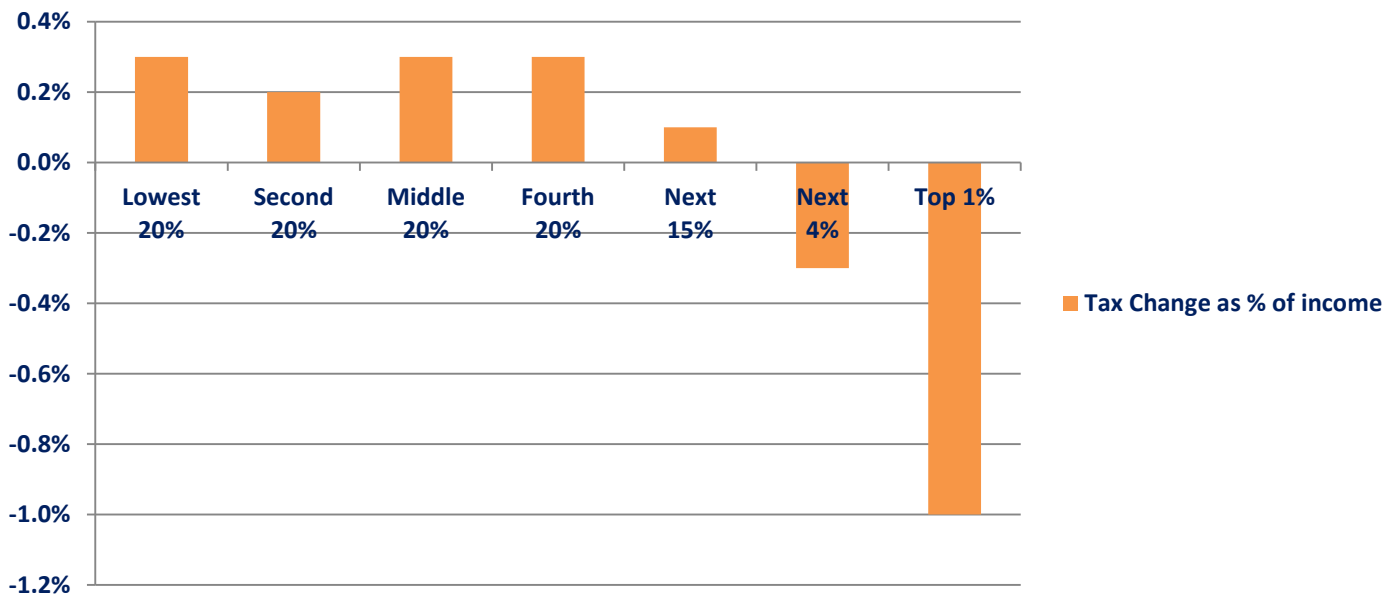
June 10, 2013

House Bill 998 proposes to cut tax rates with the goal of shifting to a consumption-based tax system. The legislation will result in a tax shift away from wealthy taxpayers and profitable corporations and towards middle- and low-income taxpayers while taking in less money for critical public services.

Updated analysis shows that HB 998 would shift the tax load to 95 percent of taxpayers, on average, while the top 5 percent of taxpayers, on average, get a tax cut.

- Those taxpayers with income less than \$169,000 will, on average, see their taxes increase under HB 998. This is because the sales tax expansion will hit harder middle and low income taxpayers who spend more of their income on goods subject to the sales tax compared to the wealthiest taxpayers.
- The personal income tax cut disproportionately benefits the wealthiest taxpayers. On average, more than a third of the total income tax cut goes to the top 1 percent of taxpayers who have average incomes of \$940,000.
- The chart below demonstrates the combined impact of the personal income and sales tax changes by different income levels. Taxes will shift away from the top 5 percent, on average, and toward everyone else.

Impact of Personal Income and Sales Tax Changes, HB 998



Source: The Institute on Taxation and Economic Policy. Special data request. June 2013.

HB 998 results in a significant loss of revenue.

- Once the tax plan is fully implemented, the fiscal impact is estimated to be \$505.9 million per year. And, over the next five years, the tax plan will reduce state revenues by nearly \$1.5 billion.
- Because HB 998 flattens the income tax, it will be 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. 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.¹

¹ 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.

HB 998 has few base-broadening provisions.

- There is very little effort to close corporate loopholes or ineffective tax breaks on the corporate side. Time and again, policymakers who have studied the state's tax code have found that this is a critical part of true tax reform.
- Without broadening the base to which the tax rate is applied, rate reductions create even greater fiscal losses.

Tax cuts are not a good strategy to grow the economy.

- The Congressional Research Service examined 65 years of federal tax and economic data and found that the top income tax rates and the top capital gains tax rate have had no discernible impact on economic growth. CRS also found that the cut in the top tax rates in recent years has not resulted in more savings, investment or productivity.²
- Low-tax states are more likely to have lower per capita income and employment growth than states with higher taxes.³ The nine states with the highest income tax rates have economies as good as, or in some cases better than, the nine states without a personal income tax.⁴
- Five states that enacted the largest tax cuts in the 1990s had weak job growth and personal income growth, while non-oil producing states that made large personal income tax cuts in the 2000s grew more slowly than the national economy.⁵
- The eight major studies published in academic journals since 2000 that have examined the effect of state personal income tax levels on broad measures of state economic growth, six have found no significant effects and one of the others produced internally inconsistent results.⁶
- Other factors are much more important to a state's economic growth. Trends in the national and international economy, a state's natural resources, the education of its workforce, the proximity to major markets, and the mix of industries in a state these are among the major factors that determine the growth of state economies. North Carolina's job creation challenges are driven primarily by the state's concentration in manufacturing pre-Recession.⁷

The bill language suggests this is a first step towards a more complete overhaul that could eliminate the personal income tax completely and shift to a consumption-based system.

- Many have stated that the end goal is outright elimination of the personal income and corporate income tax. In the pre-amble, HB 998 states as its goal a move to a consumption-based tax system.
- A gradual approach to that outcome creates the same problems for North Carolina families and the broader economy: it won't fix the state's tax code and it will make funding public services more difficult over time.

² Hungerford, Thomas L. December 2012. Taxes and the Economy: An Economic Analysis of the Top Tax Rates Since 1945 (updated). Congressional Research Service: Washington, DC.

³ Fisher, Peter, Greg LeRoy and Philip Mattera, November 2012. Selling Snake Oil to the States: The American Legislative Exchange Council's Flawed Prescriptions for Prosperity. Good Jobs First and Iowa Policy Project.

⁴ ITEP, February 2012. "High Rate" Income Tax States Are Outperforming No-Tax States. "High rate" states include California, Hawaii, Maine, Maryland, New Jersey, New York, Ohio, Oregon and Vermont. States without a broad-based personal income tax include Alaska, Florida, Nevada, New Hampshire, South Dakota, Tennessee, Texas, Washington, and Wyoming.

⁵ Leachman, Michael, Michael Mazerov, Vincent Palacios and Chris Mai, March 2013. Cuts in Personal Income Taxes: A Poor Strategy for Economic Growth. Center on Budget and Policy Priorities: Washington, DC.

⁶ Leachman, Michael, Michael Mazerov, Vincent Palacios and Chris Mai, March 2013. Cuts in Personal Income Taxes: A Poor Strategy for Economic Growth. Center on Budget and Policy Priorities: Washington, DC.

⁷ Freyer, Allan, May 2013. North Carolina's Economy is Competitive with Neighboring States. Budget & Tax Center Brief: NC Justice Center, Raleigh, NC.