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BTC Brief

NC BUDGET & TAX CENTER

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Timely, accessible, and credible analysis of state and local budget and tax issues

THE DEAD TAX PLAN: Just how regressive would it have been?

Key Finding: The proposed $1 billion compromise tax plan released the week of July 20th featured a 1-cent sales tax increase and 2% personal income tax surcharge. This plan, if enacted, would have required three times more, as a share of income, of the state's lowest-income families than of the state's top 1% of income-earners.

Plan Summary

The week of July 20th budget negotiators announced that they had come to agreement on a revenue plan that would raise $982 million. The plan, which has reportedly now been shelved, contained the following elements:

- 1 cent increase in the state sales tax ($803.5 million)
- 10-cent per pack tax increase on cigarettes ($33.3 million) and 2.8% increase in taxes on other tobacco products ($5 million)
- 4 cents per bottle increase in tax on wine ($2.9 million)
- 0.8 cent increase per can of beer or 5 cents per six pack ($12.6 million)
- 5% increase in tax on alcohol ($20.1 million)
- 2% surcharge on personal ($197 million) and corporate ($15.4 million) income taxes
- Digital downloads and on-line purchases ($8.4 million)
- Conforming to Internal Revenue Code changes (loss of $116 million)

Projected Impact on Taxpayers

Figures 1 and 2 show how major elements of the tentative, presumably now dormant, tax plan would have impacted taxpayers of different income levels. Overall the plan, if enacted, would have asked three times as much from the state's lowest-income taxpayers, as a percentage of income, than of the state's top 1% of income-earners. Similarly, the plan would have asked more than twice as much of the state's middle 20% of income-earners than of the top 1%.

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One-cent Sales Tax Increase vs. 2% Income Tax Surcharge: Which is Hardest on Working Families?

The fact is that the sales and excise tax increases in the plan would have a far greater impact on working families than the proposed income tax surcharge. In fact the proposal to increase the sales tax by 1% would have cost the middle 20% of income earners

($37,000 annual income) nearly six times more than the proposed income tax surcharge. The sales tax would cost them an estimated $130 in FY 2009-10 compared to a $23 increase in income taxes from the surcharge.

Figure 1. Impact of Tentative July 22 Tax Plan (as % of income)

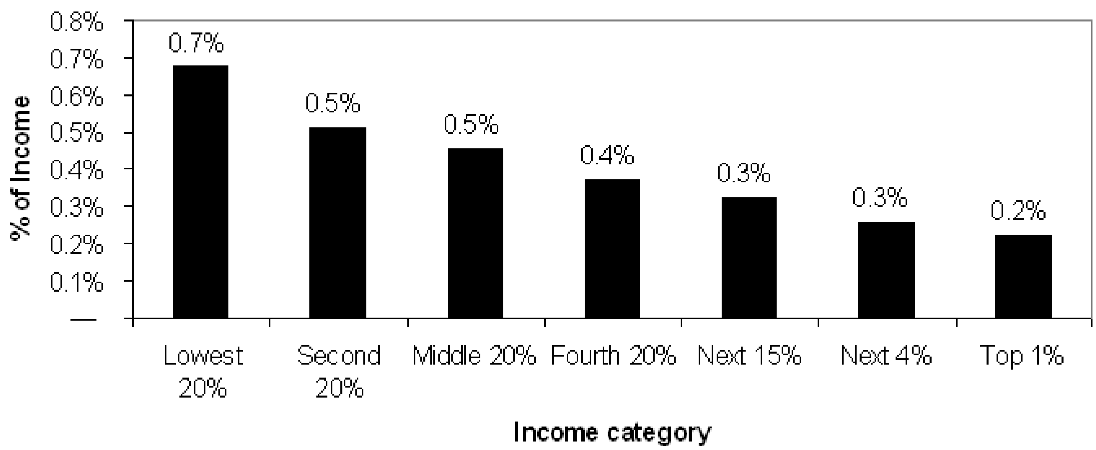

Figure 2. Impact of Tentative July 22 Tax Plan

All North Carolinians, 2008 income levels

2008 Income Group	Lowest 20%	Second 20%	Middle 20%	Fourth 20%	Next 15%	Next 4%	Top 1%
Income Range	Less Than $16,400	$16,400 – $28,600	$28,600 – $47,400	$47,400 – $77,000	$77,000 – $159,400	$159,400 – $373,100	$373,100 – Or More
Average Income in Group	$ 10,200	$ 22,200	$ 37,100	$ 60,600	$ 105,000	$ 227,500	$ 1,015,400
Tax Change as % of Income							
2% Surcharge on Post-Credit Income Tax Liability	0.0%	0.0%	0.1%	0.1%	0.1%	0.1%	0.1%
1% Sales Tax Increase (partial year)	0.6%	0.4%	0.3%	0.3%	0.2%	0.1%	0.1%
Alcohol Tax Hikes (partial year)	0.03%	0.03%	0.02%	0.01%	0.01%	0.01%	0.00%
Tobacco Tax Hikes (partial year)	0.1%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Total of All Changes	**0.7%**	**0.5%**	**0.5%**	**0.4%**	**0.3%**	**0.3%**	**0.2%**

SOURCE: Institute on Taxation and Economic Policy, July 2009

Conclusion

Any tax plan that relies more heavily on consumption taxes, whether done through rate increases or base-broadening, is going to be more regressive than a plan that relies more heavily on income tax changes. The tentative tax plan recently discussed by state lawmakers was particularly regressive because of its dependence on a broad sales tax increase on the current base and it did not include any measures to mitigate this impact such as an increase in the State Earned Income Tax Credit.

Now that it's back to the drawing board for state leaders trying to finalize a tax plan, they only need to return to the proposals put forth earlier in the year by the Senate and the House. Taken together, the two proposals include all the elements necessary to create a revenue package that would give the state a more stable and fairer tax system for the future.

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