

North Carolina's *Ongoing* Experience with Tax Reform

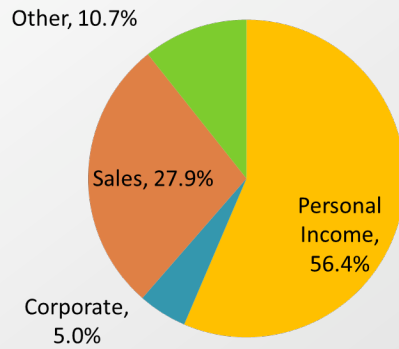
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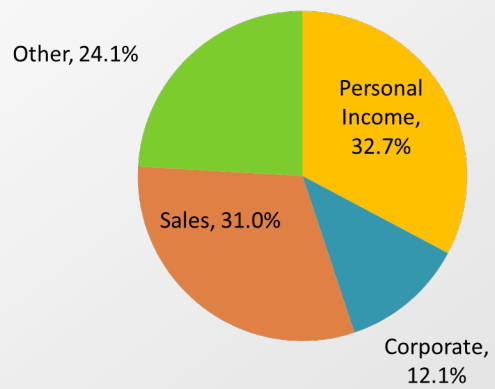
Outline

- State's tax structure
- Reform studies
- Recent attempt at reform
- Results –What was enacted
- Lessons Learned

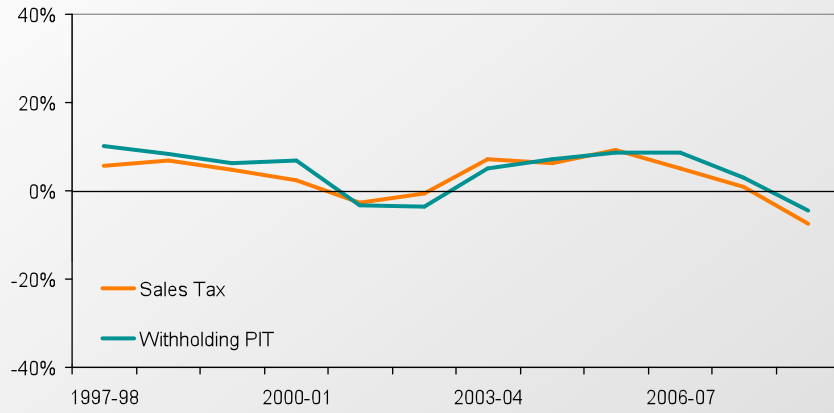
State Tax Structure, FY 2008-09



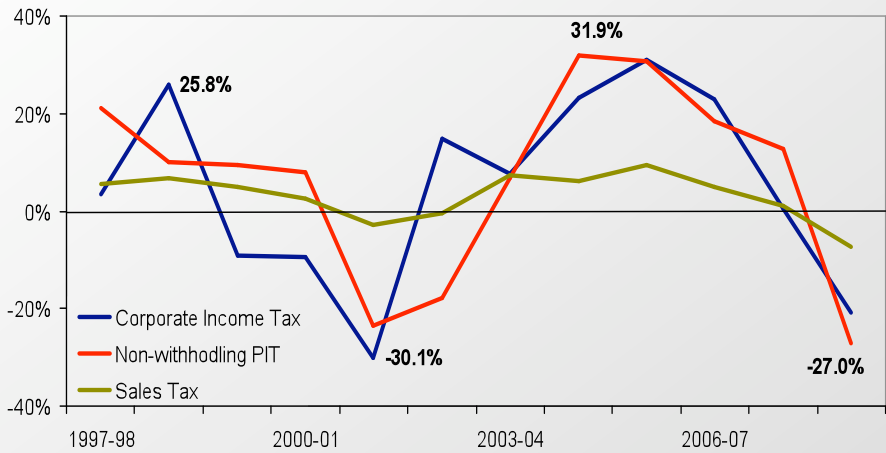
State Tax Structure, FY 1970-71



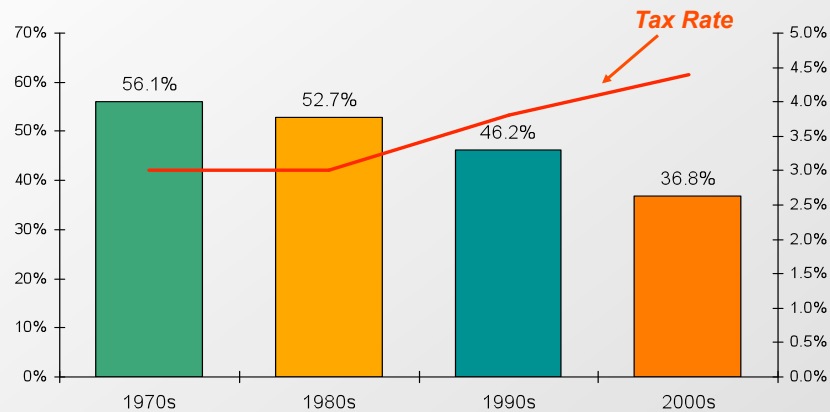
Growth and Stability



Growth and Stability



Sales Tax Base and Rate



TAX REFORM STUDIES

- **5 reform studies since 2001**
 - *Governor's Commission (2001)*
 - *Modernize State Finances (2002)*
 - *IEI's Financing the Future (2005-2009)*
 - *State & Local Fiscal Modernization (2006)*
 - *Joint Select Committee on Economic Development Incentives (2009)*

TAX REFORM STUDIES

● Goals and Conclusions

- Expand major tax bases and lower rates
- Provide stable revenues
- Eliminate tax complexity
- Eliminate non-discretionary incentives

North Carolina's Recent Experience with Tax Reform



Senate Tax Proposal

● Tax Reform Goals

- Broaden bases and lower rates
- Eliminate most credits and deductions
- Treat similar businesses the same
- Simplify tax code

Senate Proposal: PIT

- Reduce all rates and simplify (top rate 7.75%, 2008)
- Start calculation with AGI (27 other states)
- Create new zero bracket (0% up to \$10,000, MFJ)
- AGI excludes only:
 - Earned income tax credit
 - Per child credit, \$125 and retain dependent care credit
 - 6% mortgage credit, \$10,000 cap (primary residence)
 - 6% charitable credit, 20% AGI cap
 - 6% medical credit, federal eligibility
 - Retain refundable credits and R&D credit

Senate Proposal: Business Taxes

- Apply **franchise tax** to all limited liability businesses
- Repeal State and local **privilege license taxes**
- Reduce rate or eliminate **CIT**
- Repeal credits other than R&D, refundable credits, and targeted incentives
- Exempt depreciable equipment from **sales tax**; apply sales tax to most supplies and accessories

Senate Proposal: Sales Tax

- | | |
|---|---|
| <ul style="list-style-type: none"> • Expand tax base <ul style="list-style-type: none"> • Digital products and click-throughs • Warranties, installations, and repairs to TPP • Convert amusements/movie privilege tax to sales tax • Recreation and entertainment • Home and real property • Storage and moving | <ul style="list-style-type: none"> • Expand tax base <ul style="list-style-type: none"> • Building repairs and alterations, not including new construction • Web-based and other information services • Eliminate some refunds • Eliminate some exemptions • Transfer expanded local base to State |
|---|---|

Political Process

- Senate introduced the *21st Century Tax Rate Reduction and Modernization Plan*
- Conversations with Senate leadership and caucuses, House Finance chairs, and Governor
- Plan presented to the Senate Finance Committee on April 22, 2009
- Meetings with stakeholders, public groups such as the Chamber of Commerce, etc.
- Budget conference committee

What was Enacted?!



Tax Law Changes, 2009 & 2010

- **Temporary surtax on income taxes**
- **Temporary State sales tax increase**
- Expand sales tax base to include some digital products
- Increase tax rate on beer, wine, and alcohol
- Increase tax on tobacco products
- **Expanded or extended a myriad of tax credits, refunds and exemptions**

Directed Finance Committees to Study Tax Reform

- “... reform North Carolina’s sales and income tax structure in order to broaden the tax base and lower the State’s tax rates.”
- **Study Website** <http://www.ncleg.net/documentsites/committees/jhsfctr/Homepage/index.html>

LESSONS LEARNED

- **Unifying support for comprehensive reform needed**
 - Need bipartisan support, bicameral support and gubernatorial support
 - Key is full agreement on core goals
- **Legislation crafted**
 - Need a bill
- **“Process reform must extend to all the budget, not just the tax system”**
 - Eugene Steuerle, Dec. 12, 2002, “Ten Guidelines for Systematic Reform”, *Tax Notes* (Wash DC: Urban Institute)
- **Educate the public as well as the members**
 - Perceived winners not vocal; losers were vocal

Thank You

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