North Carolina’s Ongoing Experience with Tax Reform

Presentation for FTA
Sun Valley, Idaho
September 21, 2010

Barry Boardman, Ph.D.
Chief Economist
Fiscal Research Division
North Carolina General Assembly

Outline

- State’s tax structure
- Reform studies
- Recent attempt at reform
- Results – What was enacted
- Lessons Learned
TAX REFORM STUDIES

- 5 reform studies since 2001
  - Governor’s Commission (2001)
  - Modernize State Finances (2002)
  - 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**

**Expand tax base**
- 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

**Expand tax base**
- 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”**
- **Educate the public as well as the members**
  - Perceived winners not vocal; losers were vocal

---

**Thank You**

Barry Boardman, Ph.D.
Chief Economist
Fiscal Research Division, NCGA
919-733-4910
barryb@ncleg.net
http://www.ncleg.net/FiscalResearch/