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The Cost Of Trickle-Down Economics For North Carolina

Tax changes since 2013 mean the state has roughly $3 billion less for smart public investments

By CEDRIC D. JOHNSON, POLICY ANALYST and ALEXANDRA F. SIROTA, DIRECTOR

Since 2013, state lawmakers have passed significant income tax cuts that largely benefit the state's highest income earners and profitable corporations. These costly tax cuts have made the state's tax system more upside-down by delivering the greatest income tax cuts to the state's highest income taxpayers, while maintaining a heavier tax load on low- and middle-income taxpayers.

New analysis by the Institute on Taxation and Economic Policy (ITEP) finds that, since 2013, North Carolina would have $2.8 billion more in annual revenue if state lawmakers had not changed the tax system that was in place in 2013.[1] This figure is a conservative estimate because it does not include the tax changes proposed by the Senate in its recent budget, which would bring the total revenue loss to $3.2 billion. (See Appendix for details on major tax changes).

Personal income tax cuts since 2013 have primarily benefited the top 1 percent of taxpayers

The state's highest income earners—the top 20 percent of taxpayers—have received more than 80 percent of the income tax cuts that have occurred since 2013.[2] This is primarily due to the adoption of a low, flat income tax rate that replaced a graduated personal income tax rate structure that applied a higher marginal tax rate to income above certain thresholds.

As incomes in the state have grown during the ongoing recovery and that growth has concentrated at the very top of the income distribution, the low, flat income tax rate is failing to align with economic reality.[3] In 2015, the US Census Bureau found that the top 20 percent of households in the state, those with incomes of $97,000 or higher, held more than half of all household income in the state.[4]

Under the tax changes, the top 1 percent of earners (average income is $1.5 million) get an income tax cut of nearly $20,000 on average. By contrast, the bottom 20 percent of income earners (average income is $12,000) get a tax cut of just $9 on average, while middle-income earners (average income is $44,000) get a tax cut of $175 on average.[5]

Income tax cuts are not an economic development strategy

In North Carolina, the economic evidence during the national economic expansion suggests that since 2013, our state has **not** seen the decline in poverty, growth in wages or distribution of job creation statewide that would support claims that tax cuts have strengthened the state's economy.[6]

North Carolina policymakers have failed to effectively use tax dollars to deliver broad-based economic prosperity. Lawmakers have failed to boost support for many smart public investments that save tax-payers dollars in the long-run (e.g. investments in early childhood learning and development), better connect North Carolinians to work and higher wages, and revitalize communities and strengthen regional economies. Instead, income tax cuts for the state's wealthiest taxpayers are delivered year after year at the expense of these public investments.[7]

Overview of Tax Changes Since 2013

Since 2013, combined tax changes have resulted in a net annual revenue *reduction* of nearly $3 billion. Below are highlights of major changes to the state's three main tax revenue sources – which, combined, are responsible for 86 percent of total General Fund revenue.[8]

Personal Income Tax (PIT)

- Replaced tiered PIT rate structure based on a taxpayer's ability to pay with a flat PIT rate that doesn't account for ability to pay. Prior to this tax change, the top marginal PIT rate was 7.75 percent on income over $100,000 for married couples filing jointly, compared to the current flat PIT rate of 5.499 percent.
- Increased standard deduction to $17,500 from $6,000, based on a taxpayer's filing status. However, lawmakers eliminated the personal exemption deduction, which allowed taxpayers to deduct $2,500 for each individual and dependent claimed on their income tax return.
- Eliminated the state Earned Income Tax Credit, which provided a modest boost to the wages of low- and moderate-income workers. Prior to lawmakers eliminating the tax credit, working families in each of the state's 100 counties benefitted from the state EITC, which was valued at nearly $100.8 million in 2013.[9]
- Allows unlimited itemized deductions for charitable contributions as well as a combined deduction of up to $20,000 for mortgage interest and property taxes.
- Eliminated the Estate Tax, which applied to the state's wealthiest individuals and families. For 2012, only 23 tax filers were subject to the estate tax in North Carolina.[10]

Corporate Income Tax (CIT)

Since 2013, combined changes to the CIT include the following major changes:

- Reduced CIT tax rate to 3 percent from 6.9 percent in 2013.
- Eliminated share of CIT revenue that was allocated to the Public School Building Capital Fund – one of the few state supports for helping with school capital funding. At the time of repeal, a total of $81 million of CIT revenue was estimated to be transferred to this Fund for the current fiscal year 2017. With the elimination of this funding, a total of $335 million of school capital funding has not been available to schools since 2013.[11]

Sales Tax

Sales taxes particularly impact low-income taxpayers since they pay a larger share of their income in state and local taxes than the wealthy. Since 2013, combined changes to the Sales Tax include the following major changes:

- Expanded Sales Tax to (and repealed existing preferential tax rates for) entertainment services, which include live performances, motion picture or films, museums, cultural sites, and guided tours, among others. The Sales Tax has also been expanded to include various repair, maintenance, and installation services.
- Changed the way in which businesses allocate their income to determine the amount of state income tax they pay – the new formula is referred to as Single Sales Factor.[15] This change benefits large, multi-state corporations and not small, home-grown business with operations solely in North Carolina.
- Placed annual cap on sales tax refund for non-profit entities and hospitals.
- Eliminated local privilege tax.

Even if the state were not to return to the pre-2013 tax code, a revenue neutral and more balanced approach to tax changes would have allowed North Carolina to boost public investments as the economy recovered to deliver broader benefits to families, communities and strengthen the state's economic performance. North Carolina would be able to fully fund pre-K for all eligible 4-year olds, for example. Research shows that investment in early learning generates a return of up to $13 for every $1 invested. In addition, these dollars could have made post-secondary education and skills training accessible to more low-income students and adult workers to create a more skilled and trained workforce that can connect to careers in higher wage industries. The state's affordable housing crisis could have been addressed by putting dollars into the development of affordable housing in rural and urban areas and putting construction workers to work. North Carolina's experiment with trickle-down economics has failed.

Endnotes

1. Special data request to the Institute on Taxation and Economic Policy, May 2017. ITEP's analysis uses its economic incidence model to apply the 2013 personal income tax structure, corporate income tax and sales tax code to the state's taxpayers given today's income distribution.

2. Ibid

3. Saez, Emmanuel, "Striking it Richer: The Evolution of Top Incomes in the United States, updated with 2013 preliminary estimates," UC Berkeley, January 25, 2015. **http://eml.berkeley.edu/~saez/saez-UStopincomes-2013.pdf**

4. Mitchell, Tazra and Alexandra Sirota, October 2016, North Carolina's Greatest Challenge: Elevated Poverty Hampers Economic Opportunity for All. NC Justice Center: Raleigh, NC. Accessed at: **http://www.ncjustice.org/sites/default/files/POVERTY%20REPORT%202016--final.pdf**

5. Special data request to the Institute on Taxation and Economic Policy, May 2017.

6. Alexandra Forter Sirota, Allan Freyer, Marion Johnson, Patrick McHugh and Tazra Mitchell, *"State of Working North Carolina 2016: Don't Call It a Comeback,"* NC Justice Center, Raleigh, NC, September 2016. **http://www.ncjustice.org/sites/default/files/SOWNC%202016.pdf**

7. See Cedric D. Johnson, *"Final Tax Plan Falls Far Short of True Tax Reform,"* BTC Report, Budget & Tax Center, Raleigh, NC, August 2013 **http://www.ncjustice.org/?q=budget-and-tax/btc-reports-final-tax-plan-falls-far-short-true-tax-reform**; Tazra Mitchell and Cedric D. Johnson, *"Diminished Expectations And The Resulting Drag On North Carolina's Economy,"* BTC Report, Budget & Tax Center, Raleigh, NC, October 2015 **http://www.ncjustice.org/sites/default/files/BTC%20Reports%20-%20FINAL%20BUDGET%202015-17%20REPORT.pdf**; and Tazra Mitchell and Cedric D. Johnson, "*2017 Fiscal Year Budget Falls Short of Being a Visionary Plan for North Carolina's Economic Future"* BTC Report, Budget & Tax Center, Raleigh, NC, July 2016 **http://www.ncjustice.org/sites/default/files/BTC%20Reports%20-%20FINAL%20BUDGET.PDF**.

8. Leslie J. Calman and Linda Tarr-Whelan, *"Early Childhood Education for All: A Wise Investment,"* Legal Momentum, New York, NY, April 2005. **http://web.mit.edu/workplacecenter/docs/Full%20Report.pdf**

9. Noah Berger and Peter Fisher, *"A Well-Educated Workforce Is Key to State Prosperity,"* Economic Policy Institute, Washington, DC, May 2013. **http://www.epi.org/publication/states-education-productivity-growth-foundations/**

10. NC Housing Finance Agency, 2017 Annual Report, accessed at; **http://www.nchfa.com/sites/default/files/page_attachments/2017%20Report%20on%20Achievements%20FINAL.pdf**

11. *Where the Money Comes From,* FY 2016-17 Budget, NCGA Fiscal Research Divison, Raleigh, NC **http://www.ncleg.net/FiscalResearch/presentations/Where_From_Goes-FER%2020170118.pdf**

12. Fact Sheet, Budget & Tax Center, May 2015 **http://www.ncjustice.org/sites/default/files/BTC%20EITC%20Factsheet_2015_final.pdf**

13. "Repealing Estate Tax Benefits Few, Harms Many," blog post by Cedric D. Johnson, The Progressive Pulse, March 2013 **http://pulse.ncpolicywatch.org/2013/03/11/repealing-estate-tax-benefits-few-harms-many/#sthash.39KxJxF3.dpbs**

14. Fiscal notes for House Bill 998, prepared by NCGA Fiscal Research Division, June 7, 2013 **http://www.ncleg.net/Sessions/2013/FiscalNotes/House/PDF/HFN0998v3.pdf**

15. Cedric D. Johnson, *"Tax Change For Multistate Corporations,"* BTC Brief, Budget & Tax Center, Raleigh, NC, March 2014 **http://www.ncjustice.org/sites/default/files/BTC%20Brief%20-%20Single%20Sales%20Factor_final.pdf**