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August 2017

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MEDIA CONTACT:

CEDRIC JOHNSON
919-856-3192
cedric@ncjustice.org

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P.O. Box 28068
Raleigh, NC 27611-8068

www.ncjustice.org

Costly Tax Cuts in New State Budget Continue Precarious Road Ahead for North Carolina

The new tax cuts, when combined with tax cuts passed since 2013, will mean \$3.5 billion in less revenue every year for the state.

By **CEDRIC JOHNSON**, Policy Analyst

The new two-year state budget passed by lawmakers included another package of tax cuts that will further limit the amount of revenue available for public investments. The latest tax cuts will reduce annual available revenue by \$900 million and, when combined with tax cuts passed since 2013, result in an estimated \$3.5 billion in less annual revenue compared to the tax system that was in place prior to tax changes in 2013.¹

The new budget shows only \$521 million of the \$900 million in annual revenue loss, due to the way in which lawmakers phase in the tax cuts. The tax cuts kick in starting January 2019 – the second half of the second year of the two-year budget. Thus, lawmakers were not required to account for roughly \$400 million of the annual cost of the tax cuts, as the fiscal impact of the tax cuts only reflect half of fiscal year 2019 (January 2019 through June 2019). However, future lawmakers will have to address the unaccounted for \$400 million reduction in revenue availability, as the state's constitution requires lawmakers to pass a balanced state budget.

Figure 1: Details of tax changes in new FY 2018-19 budget

Major Tax Changes Included in Budget for FY 2018-19	Start Date	Pre-2013 NC Tax System
Lower Personal Income Tax rate to 5.25% from 5.499%	Beginning January 1, 2019	Tiered Personal Income Tax structure with rates of 6%, 6.75%, and 7.75% based on income level.
Increase maximum standard deduction to \$20,000 from \$17,500 based on filing status	Beginning January 1, 2019	Standard deduction amount of up to \$6,000 in addition to up to \$2,500 personal exemption deduction of for each individual claimed by taxpayer
Convert existing Child Tax Credit to a deduction of up to \$2,500 per child based on filing status and income level.	Beginning January 1, 2018	Child tax credit of \$100 per child, based on income threshold
Lower Corporate Income Tax rate to 3% from 4%	Beginning January 1, 2019	Flat 6.9% Corporate Income Tax rate
Lower Franchise Tax for S Corporations - new \$200 minimum franchise tax	Beginning January 1, 2019	\$35 minimum Franchise Tax
Exempt Mill Machinery from Sales tax	Beginning January 1, 2018	n/a
Exempt Fulfillment Facilities from Sales tax	Beginning July 1, 2017	n/a
Sales Tax Refund for "Transformative Projects"	Beginning July 1, 2018	n/a
Renewable Energy Tax Credit Extension	May 5, 2017 (for eligible property)	n/a

The costly tax cuts in the new budget represent missed opportunities by lawmakers to ensure that the needs of a growing state are adequately met and to boost public investments that promote opportunity and broadly shared prosperity. Instead, the new budget builds onto austerity budgets passed in recent years that prioritize tax cuts

that have largely benefited the highest income earners in the state and profitable corporations above all. As such, the path that state leaders continue to embark upon means that issues such as persistent poverty, income inequality, and austerity budgeting will likely persist and continue to serve as barriers to broadly shared prosperity across the state.

Here are four major implications resulting from the nearly billion dollars of new tax cuts in the new state budget.

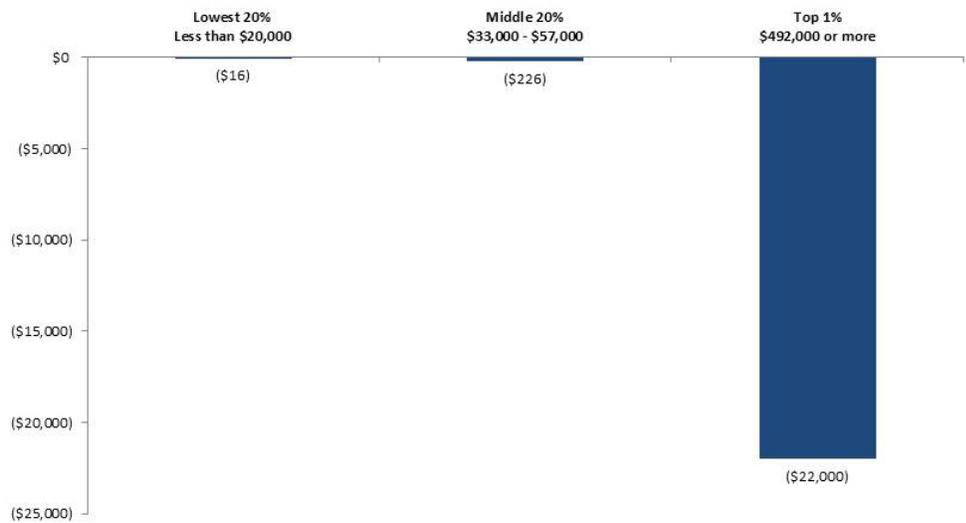
Another round of tax cuts make North Carolina’s task of maintaining public services impossible.

The new two-year budget sets the stage for reduced revenue available in subsequent years. Analysis by the NC General Assembly’s nonpartisan Fiscal Research Division highlights that revenue will fall short of spending by amounts ranging from \$1.2 billion to \$1.4 billion annually in each of the three subsequent fiscal years following the two-year budget.² The significant gaps in revenue availability suggests that existing and ongoing obligations such as keeping up with enrollment growth in public education, paying for rising costs in the delivery of Medicaid services, meeting retirement and health plan obligations for public employees, and funding the teacher pay plan will either not be fully funded or state funding cuts to public services are on the horizon, or a combination of both. The inadequate funding certainly leaves little to no room for new costs like federal cost shifts to the state in future federal budgets or another natural disaster.

Tax cuts since 2013 create a tax system that further favors the wealthy.

Tax cuts in the new budget, along with tax cuts passed since 2013 result in an estimated \$3.5 billion reduction in annual revenue.³ Taken together, these tax cuts have largely benefited the highest income earners in the state and profitable corporations. Under tax cuts since 2013, the top 1 percent of income earners (whose average income is \$1 million) gets a permanent tax cut of nearly \$22,000 a year. By contrast, middle-income taxpayers get a tax cut of around \$226 on average, while the lowest income earners in the state get a modest tax cut of only \$16 on average (see Figure 2).

Figure 2: Tax cuts since 2013 have largely benefited the highest income earners in N.C.

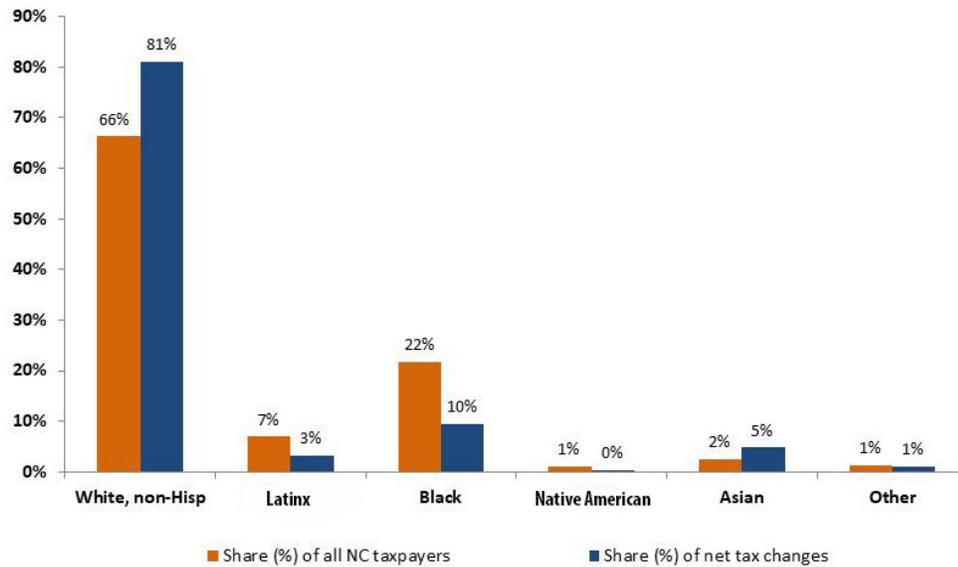


Source: Special data request to ITEP, June 2017. Results are based on all NC residents, 2017 incomes, and uses pre-2013 tax law as a baseline for comparison.

Tax cuts since 2013 reinforce racial and ethnic exclusion.

Not only have tax changes passed since 2013 held in place systems that solidify income inequality, but they also have reinforced systemic racism that excludes racial and ethnic groups from the path to upward economic mobility by delivering the greatest share of the net tax cut to white taxpayers and undercutting public investments. Eighty-one percent (81 percent) of the net tax cut goes to white taxpayers, despite this group of taxpayers representing two-thirds (66 percent) of North Carolina taxpayers. By contrast, only 19 percent of net benefits go to taxpayers of color, despite these taxpayer groups representing 34 percent of all taxpayers (see Figure 3).

Figure 3: White taxpayers get disproportionate share of net tax cut since 2013



Source: Special data request to Institute on Taxation and Economic Policy (ITEP)

Costly tax cuts in new budget mean missed opportunities to invest in North Carolinians.

Net new spending for fiscal year 2018 (the first year of the new budget), not counting additional state funding to provide pay increases to state employees, is only 1.4 percent above prior fiscal year spending. The inadequate level of state funding translates into nearly all core areas of the state budget remaining below or near-2008 pre-recession spending levels when adjusted for inflation. Without \$900 million in tax cuts, policymakers could have afforded the following investments that are tied to better economic outcomes for families and the state:

- Provide the estimated \$293 million needed by schools to meet state-mandated class size reductions.⁴
- Increase state funding to eliminate existing Pre-K waitlist and provide an estimated 37,600 additional Pre-K slots for 4-year olds not on the waitlist.
- Provide adequate funding to ensure more North Carolinians have access to affordable health care services.
- Target more state dollars to expand broadband access in rural North Carolina and reduce the existing digital divide in various areas of the state.
- Boost state funding dedicated to increase the stock of affordable housing in communities across the state confronted with a growing unaffordable housing challenge.

Steady tax cuts since 2013 have lowered the amount of revenue the state's tax system is able to raise. In reducing available resources for public investments, state leaders have essentially lowered the bar for what is possible for ensuring that communities across the state can thrive. However, a tax system that fails to position lawmakers to effectively address persistent poverty, vast income and wealth inequality, and the many distressed communities that have been left behind means the state is worse off in the face of costly tax cuts. Consequently, the path that state leaders have taken is one that lowers the bar and expectations for what is possible for the Tar Heel State.

Endnotes

1. Special data request to Institute on Taxation & Economic Policy (ITEP), June 2017.
2. Revenue shortfall figures are based on analysis conducted by the NCGA's Fiscal Research Division, July 2017.
3. See Endnote 1.
4. Kris Nordstrom, "General Assembly Must Still Provide \$293 Million in Teacher Money to Settle Class-Size Debate," blog post, The Progressive Pulse, May 2017. <http://pulse.ncpolicywatch.org/2017/05/05/general-assembly-must-still-provide-293-million-in-teacher-money-to-settle-class-size-debate/#sthash.dkOdW1u5.Zbb1AeB.dpbs>