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## Still walking the path to zero:

*The Senate tax plan will harm North Carolina's goal of building a stronger, inclusive economy*

By **ALEXANDRA F. SIROTA**, Director, Budget & Tax Center

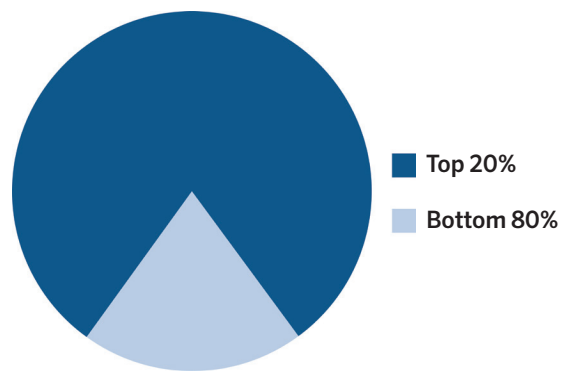
### Introduction

Senate leaders continue to pursue reductions to the income tax rate for wealthy taxpayers and profitable corporations even as they claim to be focused on helping low- and moderate-income taxpayers. This year they will do so without proposing immediate replacement of the revenue with sales-tax base expansions. The result is a loss of nearly \$1 billion in revenue, meaning that the state's tax code in the next fiscal year will bring in \$3.2 billion less than it would have under the tax code pre-2013 changes. That's more than the state currently pays for the North Carolina Community College system and the early childhood system statewide combined, and in a state that has seen its population grow by more than the entire city of Raleigh since that time.<sup>1</sup>

The top 20 percent of income earners in North Carolina would receive nearly half of tax cuts included in this proposal, relative to current law. That is more than \$300 million annually being channeled to the state's wealthiest taxpayers.

**FIGURE 1: Latest income tax cut proposal from Senate consolidates the break for the top 20 percent of taxpayers**

Share of net tax cut since 2013 by income group



SOURCE: Special Data Request to Institute on Taxation and Economic Policy, March 2017

**This is not a pathway to prosperity.** Cutting taxes for the wealthy and profitable corporations—making it impossible to invest in the education of residents, economic development of struggling communities and infrastructure that supports connecting workers to jobs—is a losing strategy for North Carolina.<sup>2</sup>

## ANOTHER \$1 BILLION LESS IN REVENUE MAKES IT IMPOSSIBLE TO BUDGET RESPONSIBLY

The Senate proposes another \$1 billion in tax cuts that will have to be made up for in cuts to public services. Importantly, the Fiscal Research Division has already identified \$680 million in immediate budget pressures for the next fiscal year, such as growing enrollment in public schools. This does not include the well-documented need for the state to support rebuilding efforts in Eastern North Carolina in the aftermath of Hurricane Matthew.

Legislators on both sides of the aisle have also stated their commitment to the following shared priorities for our state.

- **Meeting federal standards in the protection of children in foster care**
- **Preventing child abuse**
- **Improving access to mental health care for North Carolinians**

- **Matching historic investments in affordable housing development**
- **Ensuring the efficiency of the court system and access to justice**
- **Providing for the infrastructure to raise the age of juvenile jurisdiction**
- **Reaching the national average in teacher pay**

It is worth noting too that the Senate announced its plans on the day that President Trump unveiled his plans for the federal budget. The topline figures in the federal budget blueprint make clear that a significant portion of nearly one-third of North Carolina's state investments that flow from federal grants is at risk, as well as the federal commitment to fund Medicaid at current match rates of 2:1

for every state dollar. Limiting the state's revenue at a time when it is unclear what the federal government will continue to support will make it difficult for North Carolina leaders to plan for the gaps in services and investments, as well as meet new unanticipated needs that will likely arise.

All these budget pressures taken together make clear that another \$1 billion in budget cuts to fund the Senate's tax plan for the wealthy and profitable corporations is fiscally irresponsible.

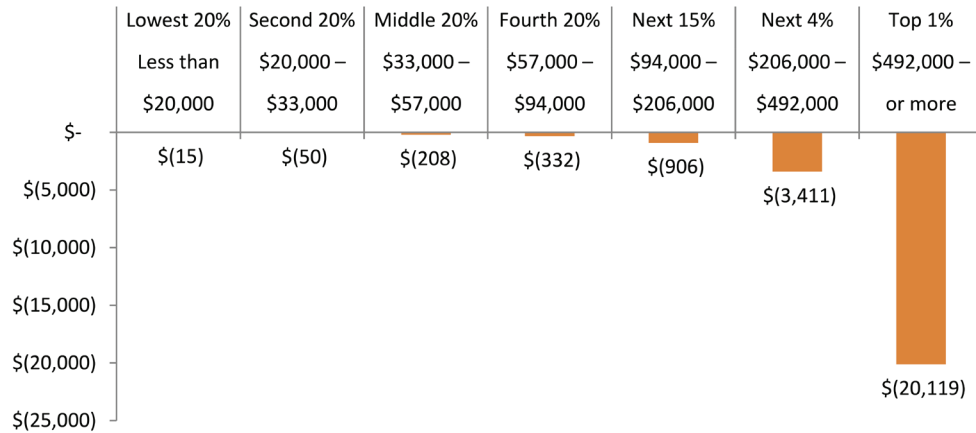
**FIGURE 2: Major budget pressures identified by the North Carolina Fiscal Research Division**

CATEGORY	Fiscal Year 2017-18	Fiscal Year 2018-19
K-12 Enrollment	45,000,000	120,000,000
Higher Education Enrollment	55,000,000	103,000,000
Retirement System	11,000,000	71,000,000
State Health Plan	80,000,000	160,000,000
Medicaid Rebase	133,000,000	270,000,000
Teacher Pay	180,000,000	361,000,000
Debt Service	24,000,000	67,000,000
Disaster Recovery (Match for Federal Dollars)	80,000,000	
<b>TOTAL</b>	<b>\$ 608,000,000</b>	<b>\$ 1,153,000,000</b>

SOURCE: NC Fiscal Research Division, Presentation to the Joint Committee on the Base Budget, 2017.

**FIGURE 3: Millionaires would receive tax cuts that are 100 times the tax cut for the middle-income taxpayer on average**

*Average tax change by income group*



SOURCE: Special Data Request to Institute on Taxation and Economic Policy, March 2017

### Latest income tax cut proposal from Senate consolidates the break for the top 20 percent of taxpayers

Analysis of the Senate tax proposal using the economic incidence model from the Institute on Taxation and Economic Policy shows that the plan will lavish the biggest tax breaks on the wealthiest North Carolinians. Eighty percent of the net tax cut since 2013 has gone to the top 20 percent of taxpayers.<sup>3</sup>

The reduction in the corporate income tax rate will reduce revenues used to support public infrastructure and workforce investments that support private businesses and strengthen communities. More than two-thirds of the tax cut on corporate profits will not be directly received by North Carolina residents but instead will go out of state.

A millionaire in North Carolina receives an average tax cut of \$20,000 under the Senate tax plan, while only a third of taxpayers who earn less than \$20,000 would get anything.

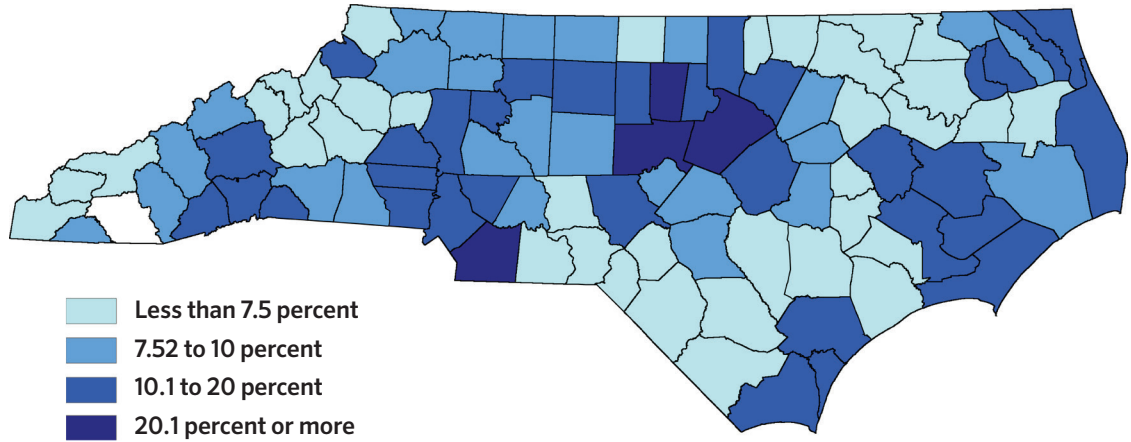
### Senate proposal won't put more money in the pockets of North Carolinians who are struggling

Senate leaders released misleading figures that seem to imply that some of the state's counties with the highest poverty rates would see the largest tax cuts, but that's simply not true. Sixty percent of taxpayers with poverty incomes and low-income taxpayers are not receiving an income tax cut under this proposal.

The major tax policies proposed in the Senate plan do not target low-income or poor households or communities. These policies seek to exempt more income from taxation, lower the rate on income that is taxed, uncap itemized deductions claimed by a very few and wealthy taxpayers. Most importantly, these income tax policies do not address the reality that many low-income taxpayers contribute through sales tax and do not have sufficient income to benefit from increasing the standard deduction or making the child tax credit progressive but not refundable.

**FIGURE 4: Nearly half of the tax cuts in the Senate’s plan will flow to the top 20 percent of taxpayers who are more concentrated in urban and suburban counties**

*Percent tax filings with adjusted gross income above \$100,000, by county*



SOURCE: IRS, SOI data by county.

For example, despite claims that the Child Tax Credit is progressive, the reality is that for taxpayers living on low incomes with children, the proposed tax changes means \$9 per child in a reduction of income taxes owed. The negative impact on funding for schools, health care and public safety is not worth the cost of such a small tax benefit for these families.

### **Rural communities will continue to be hurt by the Senate tax cut proposal**

Not only will rural communities continue to be among the hardest hit from the loss of state revenue (many infrastructure, economic development and educational investments made by the state are not possible under current austerity policymaking), most rural North Carolinians would see little to no change in their tax payments.

Those tax returns with adjusted gross income over \$100,000, a conservative approximation of the top 20% of taxpayers based on available data, represent a greater share of urban tax returns filed as evidenced by the map above.<sup>4</sup>

For example, in Rockingham County, 8 percent of tax returns has adjusted gross income above \$100K. These taxpayers will have received 80 percent of the net tax cuts since 2013 under the latest Senate plan. In Wake County, 23 percent of tax returns have incomes above \$100,000. In Bertie County, just 430 tax returns are in this group. Half of tax returns in Bertie County have incomes below \$25,000, only some of whom would receive a tax cut. The failure of the Senate tax plan to adopt refundable tax credits for families—in the design of the Child Tax Credit or adoption of a state Earned Income Tax Credit—does not effectively target families with low incomes.

These tax changes are not going to transform job creation potential in communities, but they will more than likely hamper communities in building the opportunities that increase wages, generate economic activity and support small businesses locally because they will not allow the state to make needed, targeted investments. It is also likely that, in future years, state and local leaders will have to turn to other taxes—sales and property taxes as well as fees—that ask more from low- and middle-income taxpayers if they want to make public commitments to meet rural and urban community needs.

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## More tax cuts won't strengthen North Carolina's economy

Senate leaders want North Carolinians to believe that their latest tax scheme will actually help poor and rural residents. It will not. Instead, it continues on the path to zero income tax that necessarily forces increases in taxes that ask more of middle- and low-income taxpayers or hurts the ability to build a strong foundation of support for the economy. The primary beneficiaries of the Senate leadership's proposal will be the state's wealthiest taxpayers and profitable, large corporations. At a time when state policymakers have tried to suggest that share a commitment to building quality schools, protecting children from abuse and placing them in safe foster homes, the forced austerity that they pursue belies their true intent. This is not about building a more inclusive economy. This is not a plan to grow and strengthen the middle class in North Carolina.

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1. Leachman, Michael and Michael Mazerov, March 2015. State Personal Income Tax Cuts: Still a Poor Strategy for Economic Growth. Center on Budget & Policy Priorities: Washington, DC and Mitchell, Tazra and Cedric Johnson, July 2016. BTC REPORT: 2017 Fiscal Year Budget Falls Short of Being a Visionary Plan for North Carolina's Economic Future. Budget & Tax Center: NC Justice Center, Raleigh, NC.
  2. Sirota, Alexandra, August 2016. BTC BRIEF: The Road to Nowhere Good for North Carolina. Budget & Tax Center: NC Justice Center, Raleigh, NC.
  3. Special Data Request to Institute on Taxation and Economic Policy, March 2017.  
NOTE: Adjusted gross income is a lower amount than total income figures reported in the ITEP economic incidence model and thus it is a conservative way to estimate the concentration of tax returns likely to experience tax changes specified in modelling.
  4. Special Data Request to Institute on Taxation and Economic Policy, March 2017.  
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