Radical Tax Cap Would Put North Carolina in a Permanent Bind

OPPOSE SENATE BILL 817 WHICH LOCKS IN TAX GIVEAWAYS FOR THE POWERFUL

BUDGET & TAX CENTER **FACT SHEET**

REASON #2

Don't Lock In Tax Giveaways For the Powerful

Amending the state constitution to set an arbitrary and low income tax rate cap would lock in the tax giveaways that lawmakers have already enacted since 2013. These tax changes have primarily benefited the wealthy and shifted the tax load to moderate- and low-income taxpayers, a trend that will only continue under a radical income tax cap.

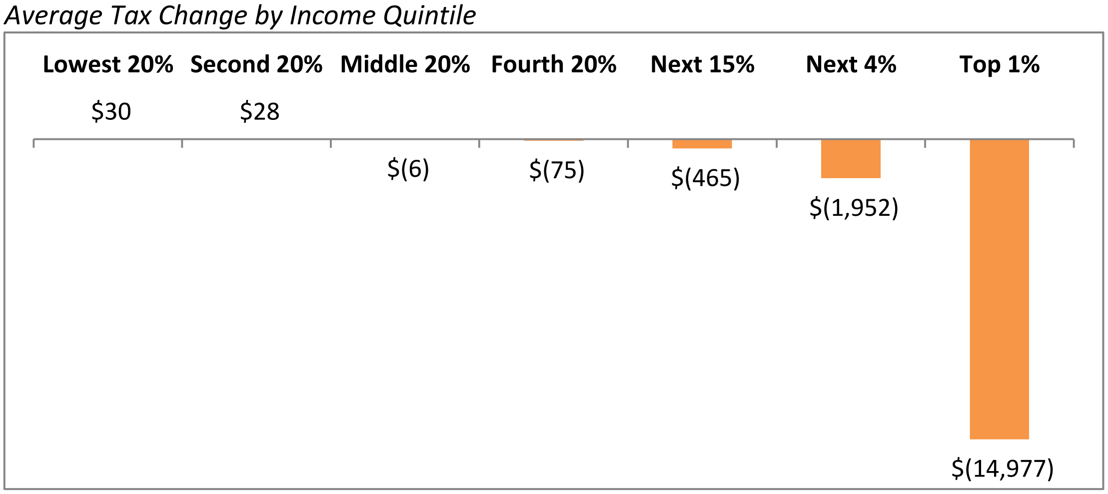
North Carolina policymakers have the power to lower the state's income tax rate without amending the state's Constitution.

Since 2013, North Carolina policymakers have changed the income tax structure away from a progressive one into a flat, low rate that will fall to 5.499 percent in January 2017. These personal income tax changes have reduced available revenue by $1.8 billion. Nearly three out of every four dollars of the benefit, on average, is flowing to the top 20 percent of taxpayers.[1]

Lawmakers have delivered nearly $15,000, on average, in tax cuts for millionaires while the middle-income North Carolinian has received just $6, on average, each year. Meanwhile, the North Carolinians who struggle the most to put food on the table and keep the lights on have received a $30 tax hike, on average (see the chart below).

Tax Changes Since 2013 Have Primarily Benefited the Wealthy

Average Tax Change by Income Quintile



Source: Special data request, Institute on Taxation and Economic Policy, April 2016. Combined Impact of Fully Phased-In PIT and Sales Tax Changes 2013-2015 (Against Baseline with 5 percent EITC).

This income tax cap would hurt our state's economic prospects in the future by limiting the tools that help ensure children, families, and communities thrive.

As noted above, the state is already losing more than $1 billion per year due to these irresponsible and lopsided tax cuts. The revenue loss is making it harder to reinvest in the state's infrastructure of opportunity that still has cracks in it due to the recession and weak economic recovery.

We all do better when our entire community thrives. For example, these revenues could benefit us all

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by addressing the long waiting lists for early childhood education programs and in-home services for older adults. Or they could be reinvested in the classroom to ensure children are learning from updated materials and that young adults have access to affordable tuition and an education that can give them a fair shot to get ahead. Or the revenues could be used to restore environmental programs that protect residents from dirty air and drinking water.

The income tax cap, just like the income tax cuts before it, will not deliver more or better jobs in communities across the state. North Carolina continues to have more jobless workers than there are jobs, and the majority of counties have more jobless workers than job openings. Poverty remains elevated despite a national economic expansion, and wages have failed to recover to where they were before the recession. Broader research testing the relationship between income tax cuts for the wealthy and profitable corporations, and job creation or other positive economic measures finds no strong relationship or reaches no consensus. Instead, it is clear that investing in education, infrastructure and other building blocks of a strong economy will deliver the greatest economic returns.[2]

This radical tax cap would likely force the sales tax and local property taxes to rise, making the existing tax shift even worse.

Lawmakers at the state and local levels will likely turn to other revenue sources—like the sales tax and property tax—and raise those rates to offset the revenue loss. Or increased fees will be required for basic public services.

This shift away from income taxes and towards sales and property taxes harms the people who least can afford it: middle-class North Carolinians and those who struggle to get by. They pay a greater share of their income in total state and local taxes than the wealthy do.[3] As such, the existing tax shift that has taken hold over the last two years would likely worsen under the radical tax cap.

The one tax tool that would help offset the lopsided nature of North Carolina's tax code is the state Earned Income Tax Credit (EITC), which lawmakers allowed to expire in 2013. The EITC was refundable and went to people who work and earn low wages, letting them keep more of what they earn. Rather than restore the state EITC, lawmakers have raised the standard deduction, which is a more costly and less targeted tax tool that people of any income—regardless of need—benefit from.[4]

If revenues plummet during the next economic crisis and the radical tax cap is in place, even the higher standard deduction could be put on the chopping block given its very costly nature and the inability to raise adequate revenues under the income tax. The story is the same for itemized deductions.

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[1] Special data request to. Combined Impact of Fully Phased-In PIT and Sales Tax Changes 2013-2015 (Against Baseline with 5 percent EITC).

[2] Sirota, Alexandra. "The Reality of Tax Cuts: A Primer on the Failings of Tax Cuts as Economic Development Strategy." NC Budget & Tax Center. July 2015.

[3] Analysis from the Institute on Taxation and Economic Policy.

[4] "Prosperity Watch Issue 58, No. 3: State EITC allows working North Carolinians keep more of what they earn, boosts economy." NC Budget & Tax Center. February 2016.