

WHAT YOU NEED TO KNOW

# Building Thriving Communities in North Carolina

A PRIMER ON THE STATE BUDGET

A Project of the  
**Budget & Tax Center,**  
part of the  
**NC Justice Center**

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# Investing In Thriving Communities



**E**very North Carolinian wants to live in a thriving community. We all want well-staffed public schools for our children to learn the skills they'll need in adulthood. We all want safe, easy-to-navigate streets so we can get where we need to be. And we all want strong local businesses that support a robust local economy.

These are all elements of a thriving community. These are all values that we share.

So how do we as a state demonstrate our values? How do we make sure our values translate into our lived experiences?

## **The state budget.**

Our state budget represents our values in practice. This handbook will explain how the budget sets priorities for our communities and impacts our quality of life. This handbook will also tell you how you can make sure your community's needs are reflected in the state budget.

Whether every North Carolina family and community can support children's healthy development depends a lot on state-level policy and investment choices. Each year, North Carolina policymakers come together in Raleigh to set priorities for how taxpayer dollars will be spent. Where policymakers choose to prioritize \$20 billion of investment is important, and your voice can make sure that their choices reflect the goals and needs of your community.

This guide provides an overview of the state budget, the budget development process, and ways that you can use your voice and engage in ensuring the state budget supports children and families.

# How Does the Budget Affect Me?

The budget is the primary document that our leaders use to enact North Carolina’s values. By allocating taxpayer dollars to programs and services, policymakers prioritize the ways they want to reflect those values in our daily lives.

That means the budget should:

- **Reflect the shared vision we have of what North Carolina communities and families need to thrive**
- **Represent smart investments and supports that best achieve our goals**
- **Effectively match investments with the growth and need we see in our state**

## NC BY THE NUMBERS

### WHEN IT’S GOOD TO RANK FIRST, NORTH CAROLINA IS...

- 26th in average pay (\$49,044)<sup>1</sup>
- 27th in business creation rate<sup>2</sup>
- 31st in early childhood Pre-K enrollment (43% of 3- and 4-year-olds enrolled)<sup>3</sup>

### WHEN IT’S GOOD TO RANK 50TH, NORTH CAROLINA IS...

- 13th in poverty rate (16%)<sup>4</sup>
- 11th in childhood food insecurity (26%)<sup>5</sup>
- 10th in low-wage jobs (31%)<sup>6</sup>

1. Corporation for Enterprise Development. (2015). Assets & Opportunity Scorecard. Available at <http://scorecard.assetsandopportunity.org/latest/measure/average-annual-pay>

2. Corporation for Enterprise Development. (2015). Assets & Opportunity Scorecard. Available at <http://scorecard.assetsandopportunity.org/latest/measure/business-creation-rate>

3. Corporation for Enterprise Development. (2015). Assets & Opportunity Scorecard. Available at <http://scorecard.assetsandopportunity.org/latest/measure/early-childhood-education-enrollment>

4. Corporation for Enterprise Development. (2015). Assets & Opportunity Scorecard. Available at <http://scorecard.assetsandopportunity.org/latest/measure/income-poverty-rate>

5. Corporation for Enterprise Development. (2015). Assets & Opportunity Scorecard. Available at <https://www.nokidhungry.org/problem/hunger-facts>

6. Corporation for Enterprise Development. (2015). Assets & Opportunity Scorecard. Available at <http://scorecard.assetsandopportunity.org/latest/measure/low-wage-jobs>

You benefit from the state budget when:	You contribute to the state budget when:
Your children or grandchildren attend school or a licensed daycare center, or visit the state zoo	You file and pay your annual state income tax
You attend a community college or university to upgrade your skills or take a course for personal enrichment	You make a purchase and pay sales taxes
You visit a state park, museum, or historic site	You renew your driver’s license
You ride on virtually any state highway, built and maintained with state funds and policed by the Highway Patrol	You buy a gallon of gas or license tag for your car
You attend a North Carolina Symphony concert in your hometown	You pay an admission charge or buy a souvenir at a state park, museum, or historic site
State aid to cities and counties offsets pressures to raise local property taxes	You buy any tobacco or alcohol product
A statewide system of courts administer a uniform justice system in all 100 NC counties	You pay a traffic ticket
State agencies respond to fire, flood, or storm emergencies in your community	You pay university or community college tuition

# Where NC Gets Its Money

The individual income tax is North Carolina's biggest source of tax revenue, bringing in \$11.3 billion in the 2016 fiscal year (FY2016). North Carolina now has a flat individual income tax rate of 5.499 percent.

North Carolina collected \$6.7 billion from our state's sales tax for FY2016. Sales of most goods are taxed at the state rate of 4.75 percent, unless the item is legally exempt or taxed at a lower preferential sales tax rate. Some services are also subject to the sales tax, but only if they are specified by law. For example, tire repair services (e.g. patches, plugs, etc.) are now subject to North Carolina sales tax, while car repair services provided via warranties included with a new vehicle purchase are not.

Corporate income taxes generated \$1.1 billion for North Carolina in FY2016. Every corporation that does business in North Carolina or that has sources of income in the state must file a state income tax return. However, many businesses don't organize as the type of corporation that has to pay corporate income tax. They often choose a different business structure that allows them to pass through business income to individual owners of the business and pay personal income taxes rather than corporate income taxes.

Of North Carolina's total revenue, 32 percent, or \$16.3 billion, came from the federal government in the 2016 fiscal year. Most federal aid goes to Medicaid, children's health insurance, and other health and human services.

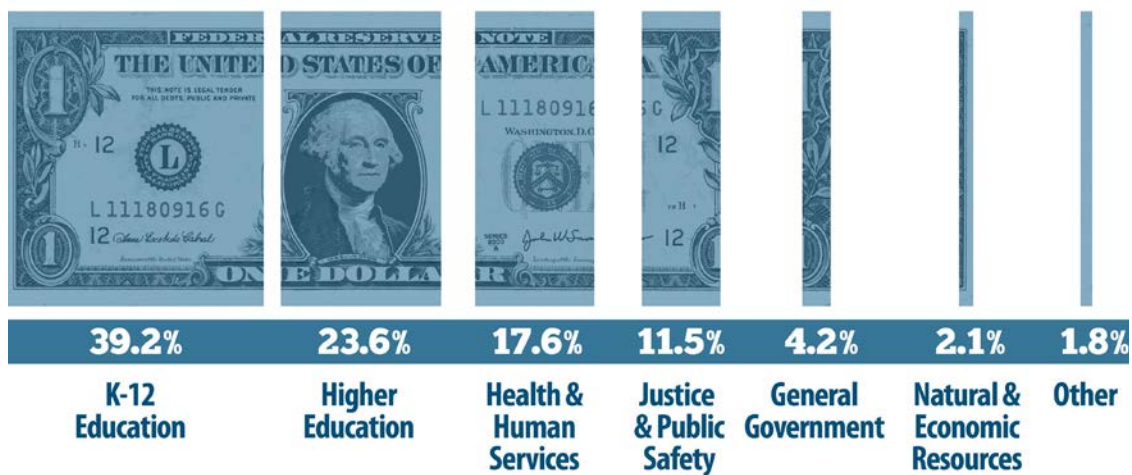
North Carolinians also pay local taxes, such as property taxes, that fund local services like police and fire protection, education, and road maintenance. Revenue from local taxes and services are not part of the state budget.

The image shows a sample of the North Carolina D-400 Individual Income Tax Return 2016 form. The form is titled "NCDOR D-400 Individual Income Tax Return 2016" and includes a section for "AMENDED RETURN" with a checkbox. It specifies the tax year as 2016, beginning on 01/01/2016 and ending on 12/31/2016. The form includes fields for the taxpayer's name, address, and Social Security Number. It also includes sections for "Deceased Taxpayer Information", "Residency Status", "Filing Status", "Adjusted gross income from your federal return", "Additions to federal adjusted gross income", "Deductions from federal adjusted gross income", "Part-year residents and nonresidents", and "North Carolina Taxable Income". The form includes a signature line and a section for "REFUND MAIL" with a checkbox. The form is dated 01/01/2016 and includes the N.C. DEPT OF REVENUE logo and address: P.O. BOX 16000, RALEIGH, NC 27604-0001.

# What the Budget Pays For

Here's a breakdown of what your tax dollar pays for:

**FIGURE 1:** Where the Money Goes



North Carolina's 2017 fiscal year budget was \$22.3 billion, and this is how lawmakers appropriated that money:

- **\$8.7 billion for K-12 education**
- **\$3.9 billion on higher education (universities and community colleges)**
- **\$5 billion on health and human services**
- **\$2.6 billion on justice and public safety**
- **\$427.5 million on general government**
- **\$536.3 million on natural and economic resources, and**
- **\$1.4 billion on other needs and obligations.**

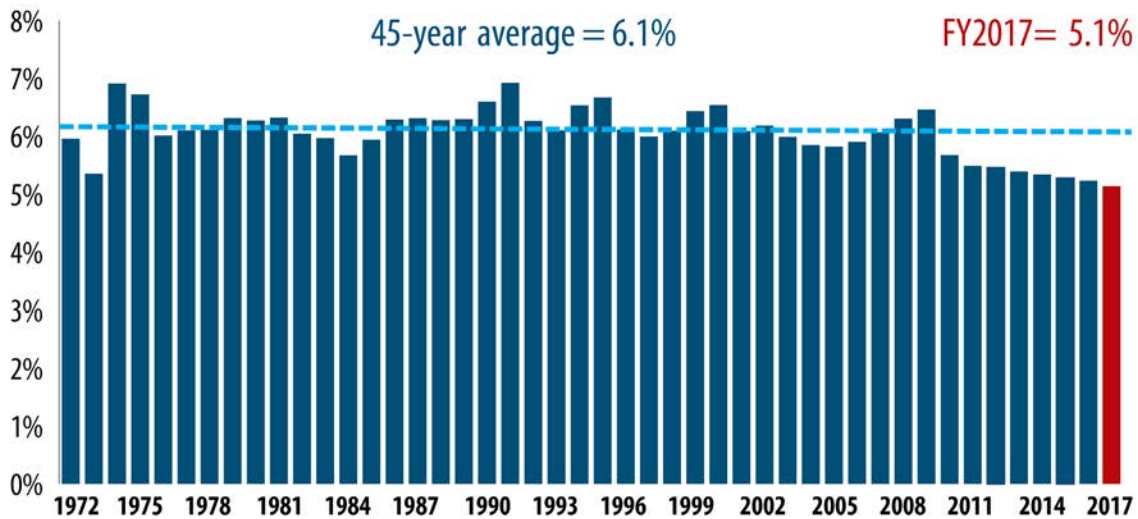
# How Does State Spending Work?

The state budget supports public services and programs that would otherwise not be delivered with the reach or quality that achieves better economic and social outcomes for our state. From universal public education to affordable health care, from protection of our natural resources to support for main street business development, the state budget includes investments that helps further our goals in education, health, environmental protection, and economic development.

In recent years, in light of the Great Recession and a significant shift in the policy approach of state leaders, the state budget has fallen short of meeting community and family needs. Even though our economy continues a modest but steady recovery, our state is missing the opportunity to truly support families in achieving greater economic security. State funding remains below pre-recession levels in many key areas eight years into the recovery, which means our communities haven't been getting the support they need for the better part of a decade.

FIGURE 2: A New Low that Hurts All North Carolinians

## State Spending as a Part of the Economy continues to Shrink, Remains Below the 45-Year Average



SOURCE: NCGA-Approved General Fund budgets, FY1972-FY2017; and BLS State Personal Income and Projections using May 2015 Consensus Revenue Forecast.

The state budget isn't the only source of support for the programs and services you see in your community. The federal government, along with local governments, also commit resources to help support programs and services that reach North Carolinians. In many instances, all three revenue sources – federal, state, and local – aim to meet the needs in communities.

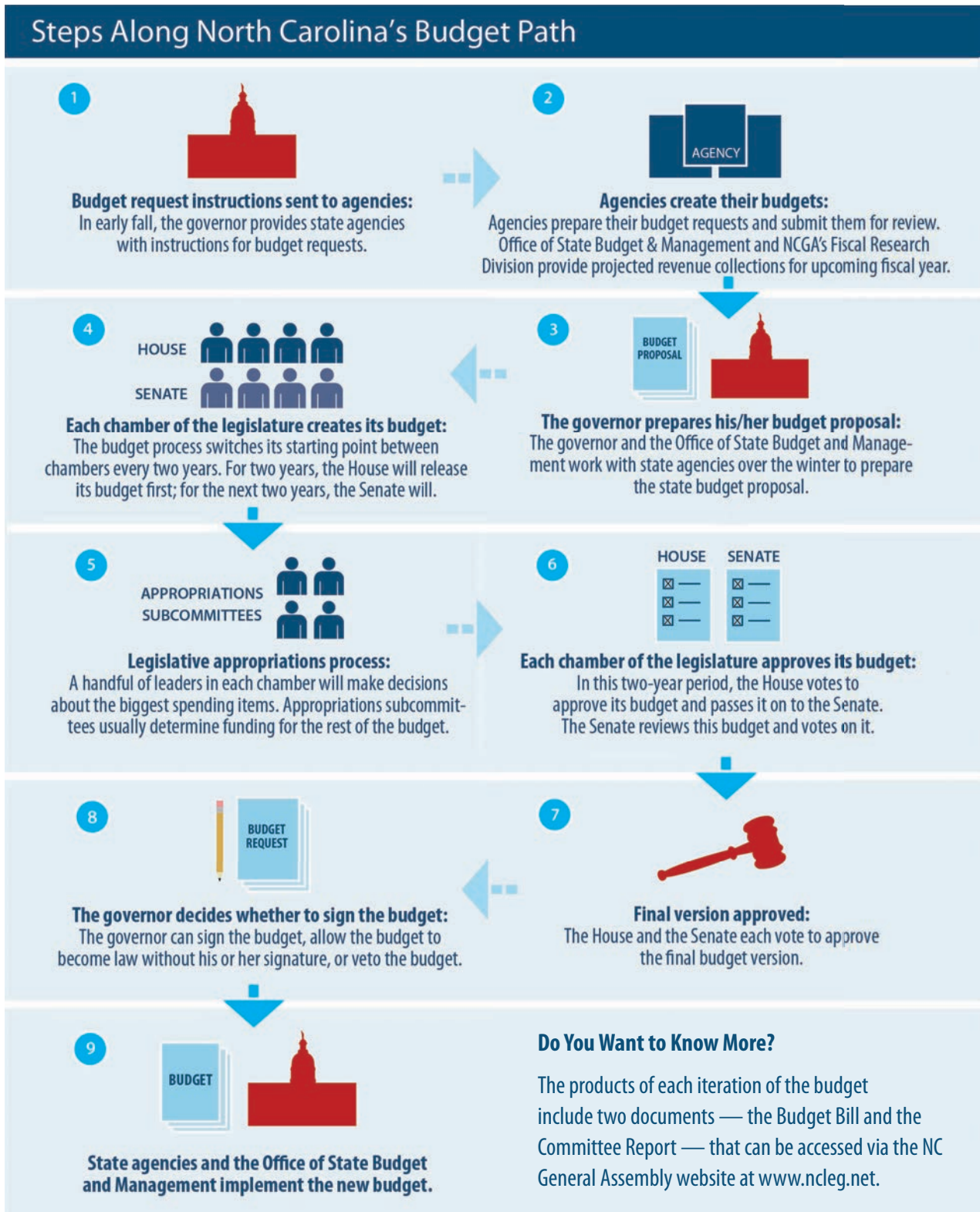
**FIGURE 3:** Sources for Select Public Programs and Services

	<b>Federal</b>	<b>State</b>	<b>Local</b>
<b>Early Childhood</b>	Funding for child care assistance, home visiting programs	Funding for child care assistance, pre-Kindergarten programming, Smart Start services, wage subsidies for child care workers	Funding for additional slots in pre-Kindergarten programs
<b>K-12 Education</b>	Funding for low-wealth schools, nutrition services	Funding for teachers, instructional supplies, and complementary support services. North Carolina public schools are primarily funded through the state.	Teacher salary supplements, school construction, and other needs based on availability of federal and state funds
<b>Healthy Communities</b>	Funding for health care access, public health programming, and pilot funding for healthy community efforts	Funding for healthy food options, parks, sidewalks	Funding for parks playgrounds, sidewalks
<b>Community Economic Development</b>	Funding for building affordable housing, supporting small business development and economic development projects	Funding for community college programs to support business start-up and expansion, and subsidies for corporations to locate in the state	Funding can be made available for main street revitalization, small business hubs, and subsidies for corporations to locate in the community

North Carolina's state budget has historically played a significant role in providing public programs and services. It allows state leaders to ensure that where you're born doesn't dictate your opportunities throughout your life, as is too often the case when communities don't have enough resources.

# How Does the Budget Get Decided?

FIGURE 4: How the Budget Gets Decided



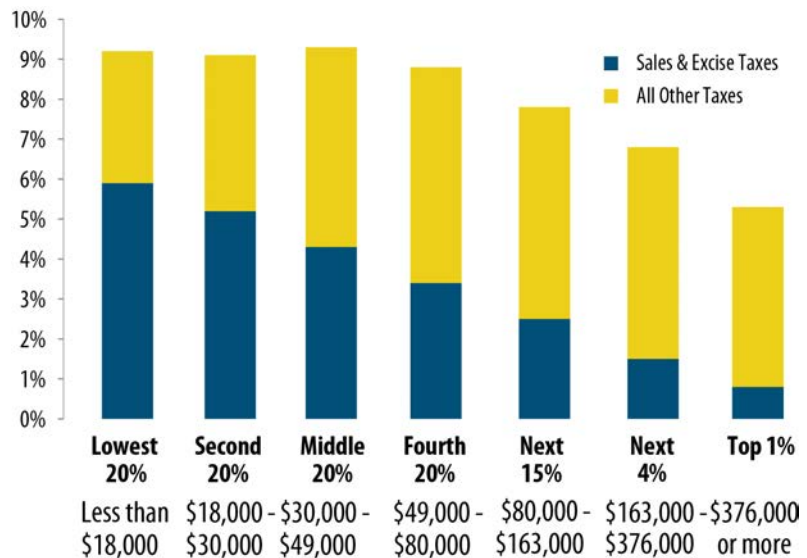


# We All Pay Taxes

Everyone in North Carolina pays taxes. Taxes are paid when North Carolinians earn income, when they buy things and when they own property, for example. These taxes fund things in our community that make a high quality of life possible.

Decisions about the state tax code are as important as the decisions about how to spend dollars. The state tax code decides how much each of us contributes as individuals or businesses. It also determines what form those taxes will take, such as income, sales, or property taxes. The way the state generates revenue impacts North Carolinians differently along the

**FIGURE 5:** Lower Income Taxpayers Pay Greater Share of Income in Sales Tax Compared to Higher Income Taxpayers



SOURCE: Institute on Taxation & Economic Policy, Who Pays, 2015. NOTE: The chart does not account for tax changes passed by the NC General Assembly in 2015.

## DIFFERENT TAX SYSTEMS

A tax system can be regressive, proportional, or progressive.

- **REGRESSIVE:** Lower-income families and individuals pay a larger share of their income in taxes than wealthier families. Sales taxes are typically regressive because they take a bigger bite out of low-income families' paychecks. High-income families spend less of their income on goods and services that are subject to sales tax.
- **PROPORTIONAL:** Everyone pays the same percentage of their income in taxes, regardless of their income and ability to pay. This can also be called a flat tax. Some call it fair, but low-income people feel the biggest pinch.
- **PROGRESSIVE:** People with higher incomes pay a higher percentage of their income in taxes than those with lower incomes. This is usually how personal income taxes are structured, and it is the most equitable system.

## EITC

North Carolina once had a policy in place, the Earned Income Tax Credit (EITC), that supported the goal of creating an economy that works for all and that helped ensure every family can make ends meet. The EITC is a tax credit for working families that reduces poverty and rewards work for low- and moderate-income households. Until recently, these households could claim the state EITC as a way to help cover basic necessities.

Here's why the EITC is good for North Carolina:

- **IT PROTECTS FAMILIES.** Too few working families are earning enough to raise their families the way we all want to. One out of every 4 children in North Carolina is currently living in poverty. The EITC lets low-income workers keep a few more of their tax dollars so they can keep their heads above water.
- **IT PROMOTES TAX FAIRNESS.** Low-income North Carolinians pay nearly twice the share of their income in state and local taxes as our state's richest residents. The EITC would help rebalance the tax load for all North Carolina taxpayers.
- **IT ENABLES AND ENCOURAGES WORK.** You have to work in order to claim the EITC, and for those with very low pay, the credit increases with earnings.
- **IT CREATES SHORT-TERM BENEFITS AND LONG-TERM GAINS.** In the short term, the EITC boosts working families' incomes. In the long-term, low-income children whose families use supports like the EITC perform better in school, are more likely to attend college, and earn more on average when they grow up.

income ladder. That's why it's important that our revenue structure follows three central values: **equity, adequacy, and stability.** In order to truly put our values into practice, our state needs a tax system that can raise adequate revenue in an equitable and stabilizing way.

**EQUITY:** Right now, N.C.'s tax code is out of balance because it asks more from low-income taxpayers than it does from the state's wealthiest residents. That is because we have shifted our tax code to rely more heavily on the sales tax, which taxes things we buy — which low- and middle-income taxpayers spend more of their income on — rather than on the amount of income we earn.

**ADEQUACY:** North Carolina's population grows every year, and community needs grow along with it. Our roads, schools, and courts need a reliable flow of revenue that addresses our needs today and our investments in the future. The current funding levels in North Carolina aren't where they should be. We're spending less on everything our communities need than we did before the Great Recession, ten years ago, and it shows. It shows in understaffed schools with out-of-date textbooks, and it shows in narrow, crumbling roads that don't have enough capacity to support increasing traffic.

It's no surprise that our current funding isn't adequate: our tax system relies more heavily on low- and middle-income households than high-income ones, even though high-income households' incomes are growing at a faster rate. The tax changes in 2013 were not revenue neutral, meaning they immediately reduced the dollars available to meet community needs.

**STABILITY:** North Carolina revenue should also be stable enough to make planning and managing public services and programs as straightforward as possible. That means having things like a robust Rainy Day Fund that can protect our economy from ups and downs. It means drawing revenue from reliable sources that aren't sensitive to economic shocks like the Great Recession. It means cutting down on loopholes in the tax system that destabilize our revenue capability.

Having systems in place like a progressive income tax, a lowered and broadened sales tax, and a loop-hole free corporate income tax would bring North Carolina's revenue structure closer to fulfilling the three values of equity, adequacy, and stability. It would make our state's economy stronger, while providing for all North Carolina families.

## Frequent Questions About the Budget

### How do people know what “well-funded” means for different budget areas?

Much of the debate in recent years has been about what our shared definition of adequate is for public programs and services. It is difficult to set a standard across all areas of the budget. Instead, there are a few helpful ways to consider whether a program or service is well-funded:

- **Is there a need going unmet? A waiting list for programs or services? A subpopulation that is not reached with the current program?**
- **Is there a more effective, efficient, innovative way to deliver the program and services that requires new capacity or infrastructure?**
- **Are we making investments in the people who deliver public programs and services that reflect a commitment to their economic security?**

### Why would there be budget cuts in good times?

Budget cuts in good times occur for two main reasons: 1) Legislators do not support the program or service and prioritize other investments and 2) There is not adequate revenue to continue to support programs and services at the prior level. In both cases, budget cuts are a result of where policymakers choose to prioritize and how policymakers choose to collect revenue. Both should reflect the interests of North Carolina families and communities.

# What You Can Do to Take Action

**Y**our voice is critical. You can share your priorities for your community in a few different ways:

- **Tell your lawmaker how the budget will help or hurt you, your family, or your community.**
- **Meet the lawmakers on Appropriations subcommittees.** They determine the funding for various programs and services.
- **If it sounds like it'll be difficult to get the funding you need, now is the time to make your voice heard!** Join with members of your community to start a lobbying campaign, for instance.
- **Follow the NC Budget & Tax Center at @ncbudgetandtax,** or sign up for our Rapid Response Email list to keep up to date and find out what you can do every week!



# Our Investments Matter

The state budget should be a clear reflection of North Carolina's values and priorities, for today and for our future. Our investments in schools, public health, roads—in other words, in our communities—will determine how our state will grow and thrive.

The budget must also ensure that North Carolina has enough revenue to support our growing needs and changing economy. Our current revenue system is out of alignment with our day-to-day reality, and it's taking a toll on our economy. Because of bad policy, investment in our communities has declined, and that will create greater challenges for all of us in the future.

If we want our communities to thrive, now and in the future, we need a state budget that prioritizes thriving communities. We need a tax system that is equitable, adequate, and stable. And we need to create that tax system together—a system by North Carolinians, for North Carolinians.



# GLOSSARY OF TERMS

**Appropriations** – the amount of money approved by the General Assembly for a certain purpose.

**Budget deficit** – the amount by which revenues fall short of expenditures in a given period, usually a fiscal year.

**Budget surplus** – the amount by which revenues exceed expenditures in a given period, usually a fiscal year.

**Corporate income tax** – a tax on the entire net income of every corporation located in North Carolina or deriving income from sources within North Carolina.

**Earned income** – money received in payment for a job or through self-employment.

**Federal funds** – U.S. government money approved by Congress to support a program or project.

**Federal poverty measure (also called the poverty line)** – standard used by the U.S. government to classify people as low-income.

**Fiscal year (FY)** – an annual accounting period. North Carolina’s fiscal year runs from July 1 to June 30. For example, the 2016 fiscal year runs from July 1, 2016 to June 30, 2017.

**Flat tax (also called proportional tax)** – a tax levied at the same rate on all levels of income.

**General Fund** – the state’s primary account. It includes revenue from North Carolina’s personal/individual income tax, corporate income tax, and sales tax. The money in the General Fund is spent on state priorities like education, public safety, and job growth.

**Graduated tax** – a type of progressive tax in which the tax rate is higher as the value of the taxed income or item increases.

**Household income** – annual income of all family members living in the same home.

**Income tax** – a tax on earned and unearned income.

**Living Income Standard** – the amount of money a family needs to earn annually to afford housing, food, childcare, health care, transportation, taxes, and other necessities. An alternative to the poverty measure.

**Medicaid** – a health insurance program, funded by federal and state governments and operated by the state, for persons below a certain income level.

**Medicare** – a federal health insurance program for the elderly and disabled.

**Payroll tax** – a tax on wages that is used to finance unemployment insurance, worker compensation, disability insurance, Social Security, and Medicare.

**Progressive tax** – a tax that requires people who make more money to pay a bigger share of their income than those who make less. A tax can be made progressive by the use of graduated rates, exemptions, deductions, or credits.

**Property tax** – a tax levied by state or local government on the assessed value of property.

**Rainy Day Fund** - If North Carolina gets more revenue from taxes than the General Assembly budgeted for, that extra money goes straight into the Rainy Day Fund. Lawmakers can choose to use the money in this fund for things like natural disasters or to cover obligations if the General Fund runs low.

**Regressive tax** – a tax that requires people who make less money to pay a bigger share of their income than people who make more money.

**Sales tax** – a tax levied by a state or locality on the retail price of an item, collected by the retailer.

**Tax base** – the total value of income, goods, properties, services, or activities subject to a particular tax or group of taxes.

**Tax rate** – the percentage of tax paid for a given level of income or value.

**Taxable income** – amount of income subject to income tax.

**Unearned income** – income such as dividends, interest, or rental fees that does not result directly from the recipient's labor.

### FOR MORE RESOURCES VISIT:

- **NC Budget & Tax Center:**  
[www.ncjustice.org](http://www.ncjustice.org)
- **North Carolina Office of State Budget & Management:**  
<http://www.osbm.nc.gov/>



[www.ncjustice.org](http://www.ncjustice.org)  
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