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BTC Brief

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Taxing Power: Exempting Select Industries from Energy Taxes Would Reduce Revenues, Be Unfair and Discourage Conservation

Manufacturers and agricultural producers in North Carolina currently pay a lower sales tax rate than other businesses on the electricity they purchase. While an economic argument can be made for eliminating that tax entirely, doing so would reduce state revenues, raise questions of tax fairness and discourage the conservation of energy.

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Taxing Energy Sales in North Carolina

North Carolina currently levies a tax of three percent on sales of electricity. Certain industries, however, pay a lower tax rate on the electricity they purchase to produce their goods. During Fiscal Year 2007, for example, agricultural producers and manufacturers paid a sales tax rate of 2.83 percent on the electricity bought for industrial purposes.

Several legislative proposals have called for eliminating the electricity sales tax paid by manufacturers and agricultural producers. The proposals also call for ending an excise tax levied on sales of piped natural gas and a fuel privilege tax paid by manufacturers. The justification is that the taxation of business inputs leads to, among other things, an inefficient allocation of economic resources. Like any question of tax policy, however, the economic rationale behind the elimination of a tax should be weighed against other policy concerns.

Competing Policy Concerns: Revenue Adequacy, Tax Fairness & Conservation

Eliminating the sales tax on electricity paid by manufacturers and agricultural producers, the excise tax on piped natural gas and the fuel privilege tax would reduce the amount of tax revenue flowing into the state's coffers. According to the Fiscal Research Division, fully eliminating these taxes would cost some \$45 million per year. Given the growing number of needed public investments, state leaders should carefully consider the impact of terminating this revenue stream.

Such a measure also raises questions of tax fairness. Eliminating the electricity sales tax for favored industries provides those industries with an advantage over other North Carolina businesses. It also increases the likelihood that other businesses will shoulder a greater sales tax responsibility than firms in the preferred industries. In fact, the fairness of energy taxes has attracted the concern of the State and Local Fiscal Modernization Commission.

Lastly, eliminating the energy taxes would do little to encourage conservation. By effectively making the cost of energy cheaper, such a measure could encourage greater energy consumption by certain industries.

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