

Equity and North Carolina State & Local Taxes

This presentation focuses on the equity of major NC state taxes (Income, Sales & Use, Corporate Income Tax) and NC local taxes (Property and Local Option Sales)

Defining Concept of Tax Equity

- Equity in terms of taxation is basically fairness in tax burden imposed by tax structures
- Usually measured in terms of ability to pay or capability to bear the burden of the tax:
 - Horizontal Equity = equal treatment of taxpayers who have equal capability to pay
 - Vertical Equity = Concerns proper relationship between relative tax burden paid by individuals with different capabilities to pay taxes: those with more capability should pay more tax

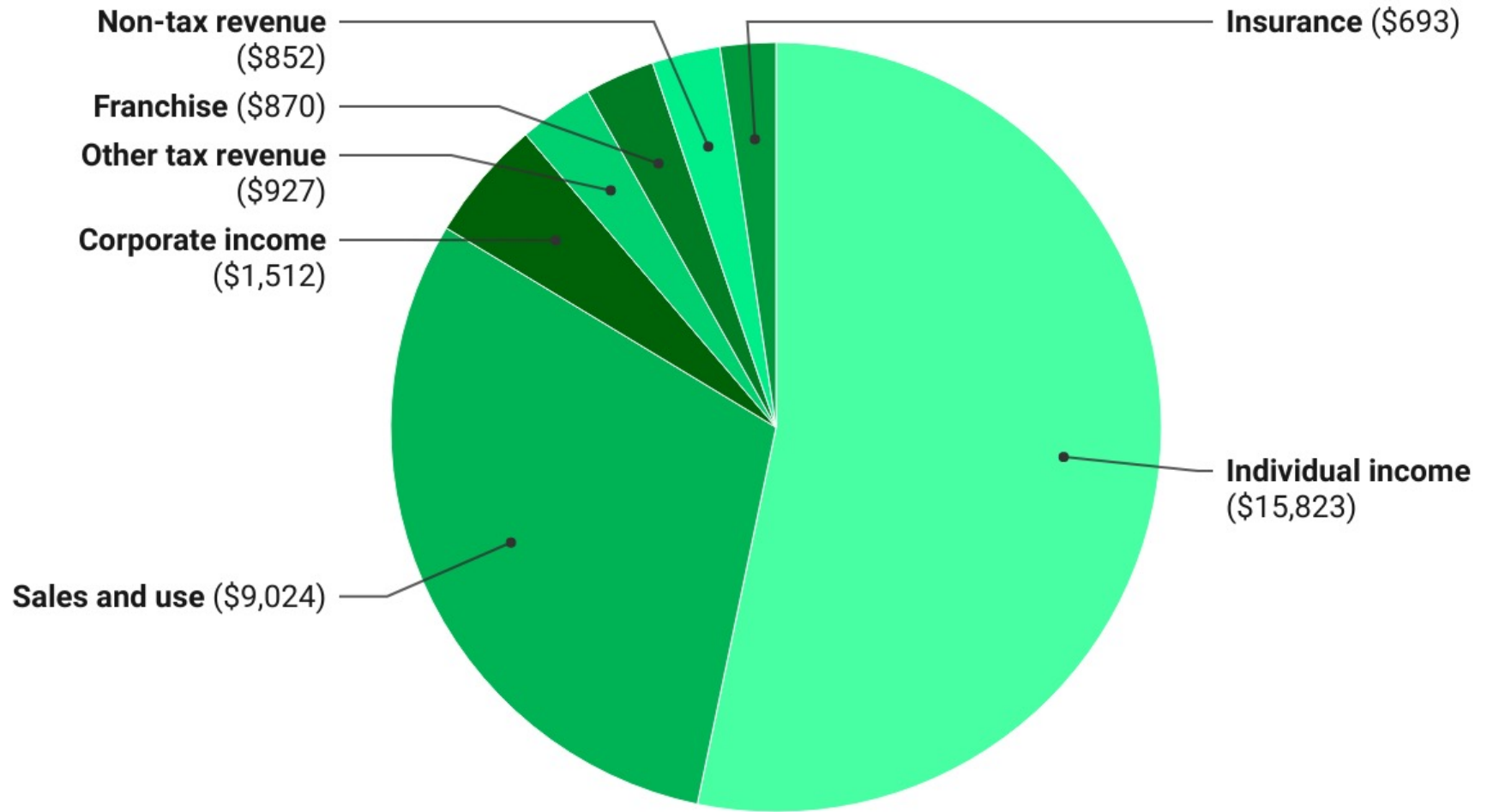
Defining Concept of Tax Equity

Gauging Equity of a Type of Tax

- Effective tax rate = Taxes Paid/ Income
- Regressive – Effective tax rates are lower in high-ability groups than in low ability groups
- Proportional – Effective rates are the same in all groups (effective rates remain constant as ability to pay rises)
- Progressive – Effective rates are higher in high ability groups than low ability groups (effective rates rise as ability to pay rises)

North Carolina General Fund Revenues, 2020-2021

NC General Fund revenues by source for fiscal year 2020-2021. Reflects figures after deductions, refunds and transfers. All figures in \$ millions.



Source: NC Department of Revenue

Chart: Carolina Forward • Created with Datawrapper

Evaluating Tax Equity of NC State Individual Income Tax

- Individual Income Tax is NC's biggest source of income: \$15.8 billion in FY 2020-2021 or 53.3% of Total Revenues
- NC has a flat or proportional individual income tax rate of 4.75% in 2023 and 4.5% in 2024.
- Flat rate for Individual Income Tax started in 2014 at 5.8% as result of tax reform ostensibly to simplify state tax law. Previously there were three individual income tax rates of 6%, 7%, and 7.75%, based on filing status and income levels.
- Individual Income Tax rates are scheduled to continue to decrease to 4.25% in 2025 and continue at 3.99% for years after 2025.

Evaluating Tax Equity of NC State Individual Income Tax

Tax changes since 2013



The Pathway to Zero: Eliminating the Tax on Personal Income

Since 2013, NC legislative leaders have been reducing the tax rate on income and making changes that have shifted the tax load from the wealthy to those with low wages. Subsequent actions by the General Assembly — like continued increases in the standard deduction or the threshold of income upon where the income tax rate is applied for most income tax filers — have not addressed the lower tax load carried by the richest 5 percent. Low- and middle-income North Carolinians now pay a total higher effective tax rate because of sales and property taxes.

Personal Income Tax Rate in NC



Source: NC Budget & Tax Center

NCBudget.org

Evaluating Tax Equity of NC State Individual Income Tax

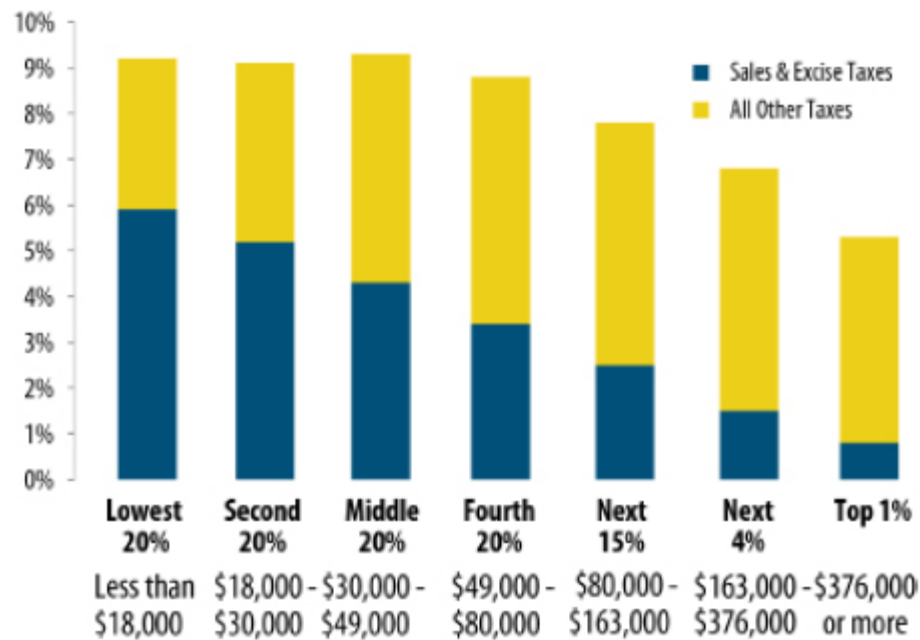
- NC's Individual Income Tax is a flat tax and proportional in terms of its rate because it applies the same rate to all income groupings.
- NC had a graduated Individual Income Tax until 2014 with three individual income tax rates of 6%, 7%, and 7.75%, based on filing status and income levels.
- Previous rate structure would be considered a progressive tax because effective rates rise as ability to pay increases.
- NC's flat Individual Income Tax is not considered equitable because it takes the same share of income from all income groupings regardless of ability to pay considerations and thus has regressive impacts, placing a greater tax burden on those with lesser ability to pay.

Evaluating Tax Equity of NC State Sales and Use Tax

- NC's Sales and Use Tax is second largest source of state income
Applies to all sales unless exempted, including some services.
- The North Carolina (NC) state sales tax rate is currently 4.75%. Total Sales Tax rates range from 4.75% to 7.5% depending on Local Option Sales Tax rate add-ons by local governments (covered later).
- Food is exempt from the State portion of Sales Tax (4.75%). Other exemptions apply, such as prescription medicine and certain medical devices and sales of items paid for with EBT cards (food stamps). These exemptions mitigate the regressive impacts to some extent, but only with respect to the state portion of the tax.
- NC's state Sales Tax is not considered equitable because the effective rate is higher for low-income groups than for high-income groups, and thus it is regressive, placing a greater tax burden on those with lesser ability to pay. (See next slide)

Evaluating Tax Equity of NC State Sales and Use Tax

FIGURE 1: Lower income taxpayers pay greater share of income in sales taxes 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.

Evaluating Tax Equity of NC State Corporate Income Tax

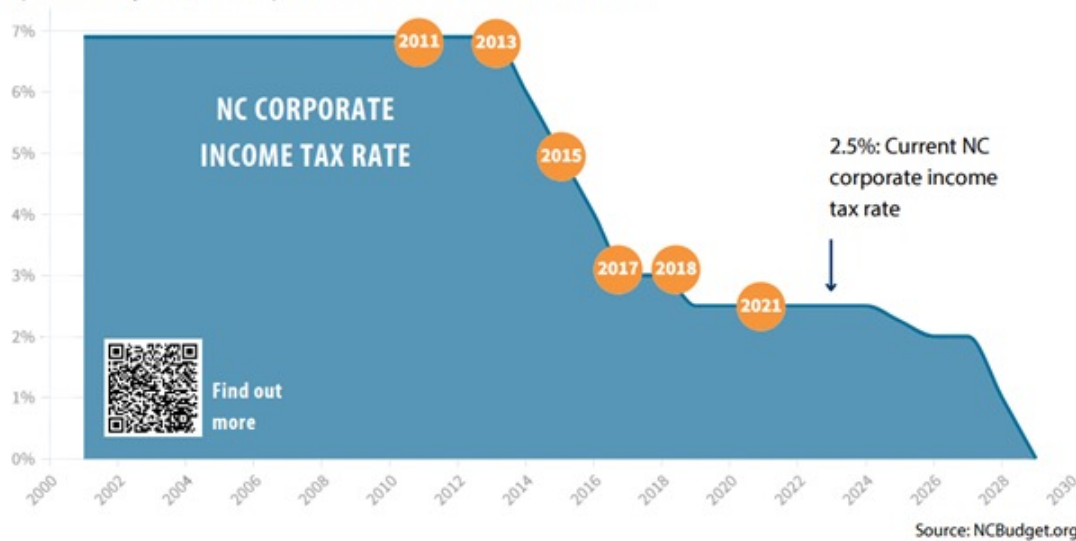
- NC's Corporate Income Tax is the third largest source of state income: \$1.5 billion in FY 2020-2021 or 5% of Total Revenues.
- NC Corporate Income Tax is a tax on the net income of any corporation located in NC or deriving income from sources in NC.
- Current corporate income tax rate is 2.5% through 2024. It was previously approximately 7% before 2014.
- After 2024, the 2.5% rate will begin a steep drop to 0% in 2030. Even before the decline to 0%, North Carolina currently has among the lowest state corporate income tax rates in the country. (See graphic on next slide)
- NC Corporate Income Tax is not considered equitable because it violates equity considerations between individual and corporate taxpayers for equitable sharing of tax burden, causing individual taxpayers to bear an increased tax burden in other state and local taxes paid to cover needed public expenditures.

Evaluating Tax Equity of NC State Corporate Income Tax

Tax changes since 2013

The Pathway to Zero: NC is Eliminating the Corporate Income Tax

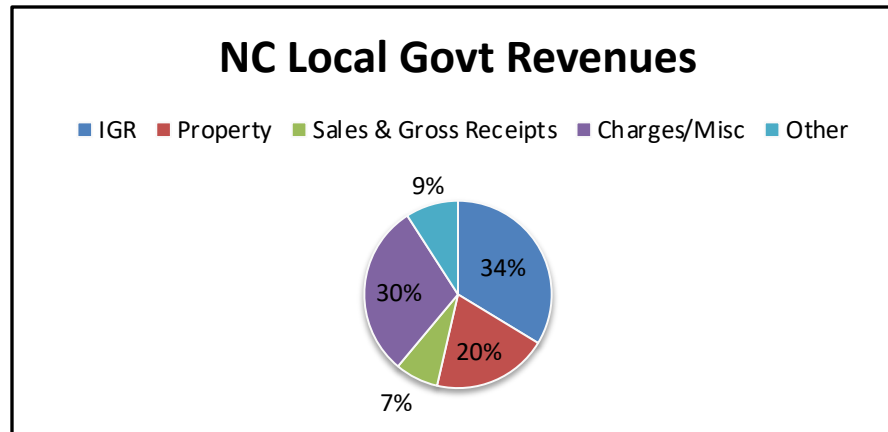
North Carolina's income tax provides a critical source of public dollars to invest in opportunity across the state, but legislative leaders have been relentless in cutting the income tax rates for corporations. By 2030, the corporate income tax rate in NC will be zero.



Source: NC Budget & Tax Center

NCBudget.org

Evaluating Tax Equity of NC Local Government Property Tax



Source: US Census Bureau, 2021 Annual Survey of State and Local Government Finances

Evaluating Tax Equity of NC Local Government Local Option Sales Tax

- Local Option Sales Tax provides 7% of total revenues at the Local Government level in North Carolina, which is relatively less significant than Property Tax at 20%, the other traditional tax structure for NC Local Governments. Other significant non-tax Local Government revenues are larger part of Total Revenues: Intergovernmental Revenues at 34% and Charges/Miscellaneous at 30%, but Local Sales Tax is still a significant traditional Local Government tax revenue.
- The North Carolina (NC) state sales tax rate is currently 4.75% for the state portion of the tax, but additional Local Option Sales Tax rates apply at the Local Government level.
- Depending on local municipalities, the total tax rate can be as high as 7.5%. County and local taxes in most areas bring the sales tax rate to 6.75%–7% in most counties, but some can be as high as 7.5%. (See Table next Slide).
- Food and other purchases, such as prescription medicine and certain medical devices and sales of items paid for with EBT cards(food stamps) are exempt from the State portion of sales tax (4.75%), but local sales taxes do apply to food to make up a 2% sales tax on food.
- Like NC State Sales Tax, Local Option Sales Tax is considered regressive because effective rate is higher for low-income groups than for high-income groups, placing a greater tax burden on those with lesser ability to pay.

Evaluating Tax Equity of NC State Sales and Use Tax (including Local Option)

Source: NCDOR

Sales and Use Tax Rates Effective October 1, 2020 through September 30, 2022
Listed below by county are the total (4.75% State rate plus applicable local rates)
sales and use tax rates in effect:

County	Rate	County	Rate	County	Rate
Alamance	6.75%	Franklin	6.75%	Pamlico	6.75%
Alexander	7%	Gaston	7%	Pasquotank	7%
Alleghany	6.75%	Gates	6.75%	Pender	6.75%
Anson	7%	Graham	7%	Perquimans	6.75%
Ashe	7%	Granville	6.75%	Person	6.75%
Avery	6.75%	Greene	7%	Pitt	7%
Beaufort	6.75%	Guilford	6.75%	Polk	6.75%
Bertie	7%	Halifax	7%	Randolph	7%
Bladen	6.75%	Harnett	7%	Richmond	6.75%
Brunswick	6.75%	Haywood	7%	Robeson	7%
Buncombe	7%	Henderson	6.75%	Rockingham	7%
Burke	6.75%	Hertford	7%	Rowan	7%
Cabarrus	7%	Hoke	6.75%	Rutherford	7%
Caldwell	6.75%	Hyde	6.75%	Sampson	7%
Camden	6.75%	Iredell	6.75%	Scotland	6.75%
Carteret	6.75%	Jackson	7%	Stanly	7%
Caswell	6.75%	Johnston	6.75%	Stokes	6.75%
Catawba	7%	Jones	7%	Surry	7%
Chatham	7%	Lee	7%	Swain	7%
Cherokee	7%	Lenoir	6.75% ^a	Transylvani	6.75%
Chowan	6.75%	Lincoln	7%	Tyrrell	6.75%
Clay	7%	Macon	6.75%	Union	6.75%
Cleveland	6.75%	Madison	7%	Vance	6.75%
Columbus	6.75%	Martin	7%	Wake	7.25%*
Craven	6.75%	McDowell	6.75%	Warren	6.75%
Cumberland	7%	Mecklenbur	7.25%*	Washington	6.75%
Currituck	6.75%	Mitchell	6.75%	Watauga	6.75%
Dare	6.75%	Montgomer	7%	Wayne	6.75%
Davidson	7%	Moore	7%	Wilkes	7%
Davie	6.75%	Nash	6.75%	Wilson	6.75%
Duplin	7%	New Han	7%	Yadkin	6.75%
Durham	7.5%*	Northampt	6.75%	Yancey	6.75%
Edgecombe	7%	Onslow	7%		
Forsyth	7%	Orange	7.5%*		

Evaluating Tax Equity of NC Local Government Property Tax

- Property Tax provides 20% of total revenues at the Local Government level in North Carolina and is a significant traditional Local Government tax revenue source.
- The property tax in North Carolina is a locally assessed tax, collected by the counties based on the assessed value of property.
- The average effective property tax rate in North Carolina (.86% in 2020) is significantly lower than the national average (1.08% in 2020). Property tax rates fluctuate in response to changes in home values, the size of the tax base, and local revenue needs. Over the past five years, property tax rates in North Carolina had an average increase of about 4.8 percent.
(<https://www.ncjustice.org/>)
- Property Tax Assessment: North Carolina's property tax is based on the value of property. A county assessor determines the value of a property and is required to revalue a property at least once every eight years. The goal of the reappraisal is to determine the current market value of the property. Maintaining assessed values at fair market value insures equitable application of Property Tax rates.

Evaluating Tax Equity of NC Local Government Property Tax

- Property Tax Exemptions/Exclusions may mitigate inequities in the NC Property Tax to some extent, insuring that those with less ability to pay or other adverse considerations receive some Property Tax relief:
 - Elderly or Disabled Homestead Exemption
Qualifying residents may receive an exclusion of either \$25,000 or 50% of the taxable value of the residence, whichever is greater.
 - Elderly or Disabled Property Tax Deferral (Circuit Breaker)
The Circuit Breaker program allows qualifying residents the option to defer a portion of the property taxes owed on their permanent residence. Residents with income of \$36,700 or less can defer the portion of property taxes that exceeds 4% of the owner's income. Residents with Income of \$36,700 – \$55,050 can defer the portion of the property taxes that exceeds 5% of the owner's income.
 - Disabled Veteran Homestead Exclusion
North Carolina excludes from property taxes the first \$45,000 of assessed value for specific real property occupied as a permanent residence by a qualifying owner. Co-owners who are not spouses and who are individually eligible for the benefit will receive the total exemption of \$90,000. There is no age or income requirement for this program.
 - Present-Use Value Assessment: Commercial producers of agricultural, horticultural, or forest products are eligible to apply for tax assessment on the basis of present use, rather than full market value.
 - Builder Property Tax Exemptions: Exemptions are available for qualifying residential and commercial builders.
 - Historic Properties: Properties designated as historic properties may be eligible for property tax deferrals.

mecknc.gov/property-tax-relief-apply-now-break-your-bill
- Despite Property Tax exemptions and exclusions, NC Local Property Tax remains a regressive tax because those in low – income groups have a higher effective tax rate than those in high-income groups. Ability to pay is not taken into account. Quality of assessment and exemptions/exclusions can help with equity considerations.

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NC State Taxes and Equity

- Major Tax Code Changes made to NC State taxes (Income, Sales, and Corporate) in 2013 have varying regressive (R) or progressive (P) impacts:
 1. Established a flat income tax rate (R)
 2. Broadened the base of sales tax to services (R)
 3. Eliminated refundable tax credits and exemptions (R)
 4. Eliminated estate tax (R)
 5. Capped itemized deductions (P)
 6. Raise the standard deduction (P)
 7. Phased down corporate income tax (R)
 8. Phased down franchise tax (R)

Source: NCBTC

- NC State Tax rates lowest in the nation and were in the middle range in 2013 before tax cuts.

(Source: NCBTC)

	Tax Rate (2024)	Tax Rate (2013)
Personal Income Tax	4.5%	6%, 7% and 7.75%
Corporate Income Tax	2.5%	6.9%
Sales Tax	4.75%	4.75%

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NC State Taxes and Equity

- Richest North Carolinians receive the largest share of total tax cuts each year, and racial inequities are reinforced (Source: NCBTC).
- Summary of Findings for NC State Tax Structures:
 1. Personal Income Tax structures are normally progressive by design, but NC's flat Individual Income Tax is proportional and not considered equitable because it has regressive impacts, placing a greater tax burden on those with lesser ability to pay.
 2. NC State Sales Tax is also not considered equitable because the effective rate is higher for low-income groups than for high-income groups, and thus it is regressive, placing a greater tax burden on those with lesser ability to pay.
 3. NC Corporate Income Tax is not considered equitable because it violates equity considerations between individual and corporate taxpayers for equitable sharing of tax burden, causing individual taxpayers to bear an increased tax burden in other state and local taxes paid to cover needed public expenditures.

Equity and North Carolina State & Local Taxes

NC Local Government Taxes and Equity

- Summary of Findings for NC Local Government Tax Structures:
 1. Like NC State Sales Tax, Local Option Sales Tax is considered regressive because effective rate is higher for low-income groups than for high-income groups, placing a greater tax burden on those with lesser ability to pay.
 2. Despite Property Tax exemptions and exclusions, NC Local Property Tax remains a regressive tax because those in low –income groups have a higher effective tax rate than those in high-income groups. Ability to pay is not taken into account. Quality of assessment and exemptions/exclusions can help with equity considerations.

Concluding Assessment of Tax Equity for NC State Taxes and Local Government Taxes

- There are few bright spots with respect to Tax Equity at the state and local levels in NC. In addition, current legislative tax policy at the state level plans continued reductions in State Personal Income Tax and Corporate Income Tax and continued reliance on State Sales Tax, all of which have negative impacts of State Tax Equity.
- The conversion to a Flat or Proportional Income Tax Structure is perhaps the most significant detriment to State Tax Equity overall since State Income Tax is such a substantial proportion of State Total Revenues, and other tax structures are by nature regressive in most respects.
- NC State Sales Tax is a regressive tax structure by nature but has been made somewhat less regressive for the state portion of the Sales Tax by excluding food, prescription medicine, and food stamp purchases.
- Corporate Income Tax rate reductions contribute to State Tax inequities by reducing business/corporate share of tax burden versus Individual tax payers paying other types of State taxes.
- Local Government Tax structures (Local Option Sales Tax and Property Tax) have regressive impacts. Quality of Assessment process and Exemptions/Exclusions may mitigate regressivity of Property Tax to some extent. Local Option Sales Tax could be made less regressive by eliminating sales tax on food at the local level.