

North Carolina: Policy groups disagree over the effects of tax reform



David M. Kall | Thursday, November 9, 2017

In its newly released [2018 State Business Tax Climate Index](#), the Tax Foundation ranked North Carolina at number 11 for the second year in a row. These are the rankings in each individual component, which make up the state's overall score:

- Corporate tax rank: 3
- Individual income tax rank: 13
- Sales tax rank: 20
- Property tax rank: 32
- Unemployment insurance tax rank: 6

In 2015 and 2016, North Carolina also ranked quite well, at number 12 for both years. Thus, the Tax Foundation continues its love affair with the state that continues to struggle with significant political and economic turmoil.

The main reason for the group's ongoing appreciation is the 2013 tax reform package that set a number of tax improvements into motion. In our late June [article](#), we addressed the budget that lawmakers had just passed, after vetoing Gov. Roy Cooper's override, and related issues.

Now, in a late October [blog post](#), the Tax Foundation notes that the state is "continuing this momentum. In [its] recently adopted budget, [North Carolina] plans to adopt even more tax reforms in 2019."

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These reforms include the following:

- **Individual income tax:** In 2019, the individual income tax rate would decrease from 5.499 percent to 5.25 percent.
- **Standard deduction:** The standard deduction would increase in 2019. For single filers, the deduction would increase from \$8,750 to \$10,000, while married filers would see an increase from \$17,500 to \$20,000.
- **Corporate income tax:** Also in 2019, the corporate income tax rate would fall from 3 percent to 2.5 percent.
- **Franchise tax:** Effective 2019, S corporations would face a lower franchise tax liability. S corporations would pay a flat \$200 on their first \$1 million in value, instead of 0.15 percent. The 0.15 percent rate would apply to any firm's taxable value above \$1 million. The franchise tax for C corporations is not impacted.

If the Tax Foundation regrets anything, it is that “[u]nfortunately, these changes, when implemented, won't increase North Carolina's official score on the *State Business Tax Climate Index*. The state's ranking of 11th is very difficult to improve upon, but [it] should be applauded for continuing its positive, pro-growth tax changes.”

The [North Carolina Chamber](#) is another fan of the tax reforms. Citing the Tax Foundation's excellent rankings of North Carolina, it pledged its ongoing devotion to low taxes: “As we continue to see positive bottom line savings for job creators from these successful reforms, the North Carolina Chamber is committed to keeping our business tax code moving up the competitive leaderboard in the years ahead.”

Opposing views

As is par for the course in North Carolina, not everyone is so thrilled. In its Oct. 30, 2017 issue of [Prosperity Watch](#), North Carolina Justice Center's Budget and Tax Center contended that the tax policies serve as a “cautionary tale that simply cutting taxes will do little to improve our economic fortunes, while draining public coffers of the funds needed to address our most pressing economic challenges. Years of tax cuts in North Carolina have failed to supercharge the state's economy, which has been outpaced by peer states that have made very different policy choices.”

The article examined North Carolina's private sector employment growth since 2014 using data from the U.S. Bureau of Labor Statistics' Analysis of Current Employment Statistics. While conceding that the state's eight percent growth is slightly above the national average, Prosperity Watch pointed out that the growth rate is below that of thirteen other states, including two of North Carolina's three neighbors, Tennessee and South Carolina. In particular, North Carolina falls behind Nevada, the jurisdiction with the highest growth rate, at close to 14 percent, and then Utah, Florida, Washington, Oregon, Idaho, Georgia, Colorado, California, Arizona, Tennessee, South Carolina and Texas, all of which have outpaced the Tar Heel State.

Prosperity Watch further observed that North Carolina's job growth rate was slower than several other states in the region, like “Georgia, Florida, Tennessee, and South Carolina--none of which have embarked on a series of tax cuts on par with policy changes in North Carolina. Perhaps even more damning for the argument that North Carolina is a great example of how tax cuts impact economic growth, jobs have been slower to grow here than in several states that are hardly synonymous with tax cuts, like Washington, Oregon, and California.”

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Tax reforms and school funding

In September, the Budget and Tax Center **opined** that the new budget short-changes investments that support early childhood development education.

Financing for K-12 education is problematic also, to the point that lawmakers formed a **joint legislative task force on education finance reform** this year. This followed what **North Carolina Policy Watch** characterized as a “scathing” November 2016 **report** from the legislature’s Program Evaluation Division (PED Report), which “pointed to major fissures in the state’s funding system.”

The PED Report studied the structure of the allotment systems used to distribute state resources, such as the formulaic factors, policies, procedures, and processes. It found, among other things, that wealthy counties are favored; localities that have more disabled students receive disproportionately less funding; small county funding is duplicated and unsubstantiated; and low wealth funding is overly complex.

It ultimately recommended that “the General Assembly should either:

1. Overhaul the system for how resources are distributed by using a weighted student funding model.
2. Reform the current allotment system by addressing individual allotment deficiencies and providing direction to improve transparency and accountability.”

The Policy Watch piece reported that Gov. Cooper, a democrat, intends to tackle school funding with a commission that he formed over the summer, while the Republican dominated task force will continue its work into 2018 separately. Yet a third assemblage, of business and political leaders, will also consider improvements. North Carolina provides \$7,300 of funding per student, which is as bad as its tax rankings are good, at number 43 in the nation.

The task force chair said his people will study other states’ education funding models, because “[w]e cannot afford, in this state, a permanent underclass. We cannot raise a generation of farmhands.”



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