North Carolina: Tax Foundation characterizes the state as a model for tax reform

David M. Kall | Thursday, April 27, 2017

The Tax Foundation, whose singular vision is "a world where the tax code doesn't stand in the way of success," has become bullish on North Carolina's tax reform success, going so far as to characterize it as a "model for tax reform" in a speech last week at an event.

In its 2017 State Business Tax Climate Index the Tax Foundation swooned over the Tar Heel State's "most dramatic improvement in the Index's history—from 41st to 11th in one year." The index considers how well states structure their tax systems relative to each other, rather than how much state governments collect in taxes, in part because "even in our global economy, states' stiffest competition often comes from other states." Indeed, tax competition is an "effective restraint on state and local taxes…states with more competitive tax systems score well in the Index, because they are best suited to generate economic growth."

To compile its rankings, the Tax Foundation built a hierarchical structure from five components, which are not weighted equally. Instead, each component is weighted based on the variability of the fifty states' scores from the mean, resulting is a heavier weighting of those components with greater variability. This leads to the following weight per component:

- Individual income taxes: 32.6 percent
- Sales taxes: 22.7 percent
- Corporate income taxes: 19.7 percent
- Property taxes: 14.9 percent
- Unemployment insurance taxes: 10.1 percent

The 10 best states in the 2017 index, stemming from factors such as the absence of a major tax type, like an income or sales tax, and/or low rates, are:

1. Wyoming
2. South Dakota
3. Alaska
4. Florida

5. Nevada
6. Montana
7. New Hampshire
8. Indiana
9. Utah
10. Oregon

The 10 worst, so ranked because they have complex, and/or non-neutral taxes with comparatively high rates, are:

1. Louisiana
2. Maryland
3. Connecticut
4. Rhode Island
5. Ohio
6. Minnesota
7. Vermont
8. California
9. New York
10. New Jersey

Despite North Carolina's absence on the top 10 list, Tax Foundation appreciates the reforms, giving it a gold star for its continued improvements in its tax structure. The state now has the lowest-rate corporate income tax in the country, at four percent, down from five percent the previous year. This rate cut propelled North Carolina two ranks, from 6th to 4th, on the corporate income tax component, which is the second-best ranking, after Utah, for any state that imposes a major corporate tax.

Additionally, North Carolina has an individual income tax reduction scheduled for 2017, from 5.75 to 5.499 percent. At 11th overall, it trails only Indiana and Utah among states that do not forego any of the major tax types.

It should be noted that the Tax Foundation criticized one component of North Carolina's tax strategy, that of "lur[ing] business with lucrative tax incentives and subsidies instead of broad-based tax reform…a dangerous proposition…" For example, several years ago, the state "agreed to $240 million worth of incentives to lure Dell to the state. Many of the incentives came in the form of tax credits from the state and local governments. Unfortunately, Dell announced in 2009 that it would be closing the plant after only four years of operations."

A "far more effective approach is the systematic improvement of the state's business tax climate," keeping in mind that taxes matter to businesses." Moreover,

> Every tax law will in some way change a state's competitive position relative to its immediate neighbors, its region, and even globally. Ultimately, it will affect the state's national standing as a place to live and to do business. Entrepreneurial states can take advantage of the tax increases of their neighbors to lure businesses out of high-tax states.

Despite the Tax Foundation's glowing support, we recently explained that although North Carolina's budget is in the black with a $552.5 million surplus, not everyone is cheering. Some are concerned that the newly proposed cuts, a continuation of the 2013 reform, leave too many taxpayers out, while also making it more difficult to invest in education, economic development of struggling communities, and infrastructure, all of which would help low income citizens.

Along these lines, in a new article, North Carolina Policy Watch points out that even though current law requires school districts to reduce class sizes in grades K-3 in the upcoming 2017-18 school year, the General Assembly has failed to provide the funding necessary to allow districts to meet these class size goals. In an analysis on this topic, the North Carolina Justice Center issued "Class Size Chaos," observing that school "districts scrambling to meet new requirements by initiating layoffs and eliminating enhancement teachers, making controversy over the requirements the biggest issue facing the state's public schools in the 2017 legislative session."

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Team member bio