

# The State of State Taxes

---

Whitney Afonso  
Associate Professor  
UNC School of Government

1

## Agenda

---

The state of our state's revenue

Local government revenues

Examples of tax policy innovations from outside of NC

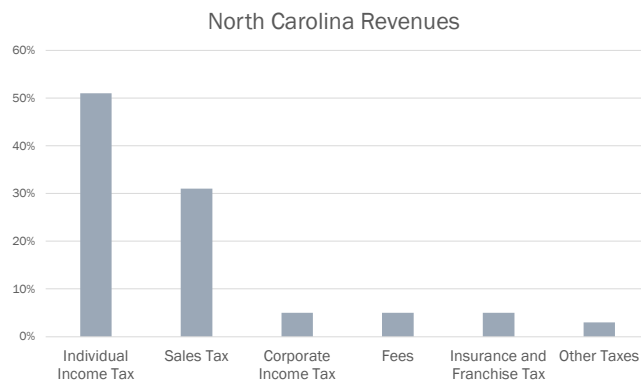
5

# North Carolina's Revenues and Tax Policy

A DECADE OF CHANGE

6

## Revenue Streams



7

# Broad Base, Low Rates

## Income Tax

- Broaden the tax bases by eliminating more than 35 tax credits, deductions, and exclusions
- Lowered both the personal and corporate tax rates
  - PIT reduced from a graduated rate schedule to a flat rate of 5.25%
  - Increased the standard deduction amount ("zero tax bracket") to \$21,500 (MFJ) from \$15,000 (MFJ)
  - CIT rate reduced from 6.9% to 2.5%

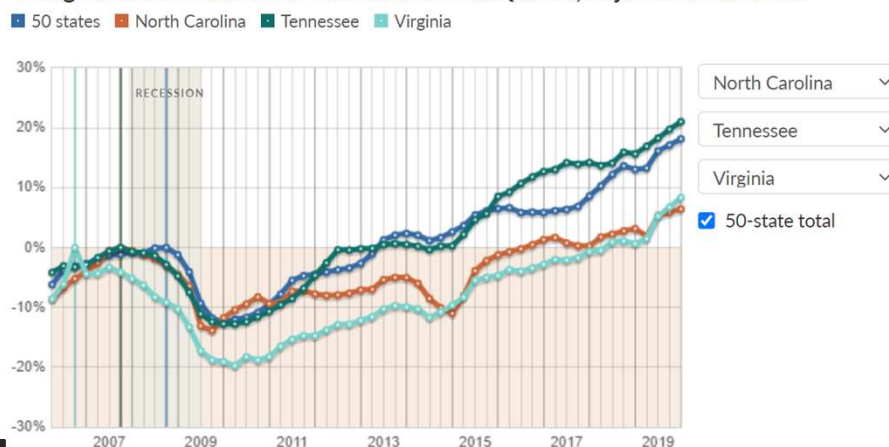
## Sales Tax

- Broaden the tax base by eliminating many tax exemptions and expanding the tax base to include certain services
- Did not change the tax rate of 4.75%

8

# Revenues: Post-Recession & Reform

Change in Tax Revenue From Each State's Peak Quarter, Adjusted for Inflation

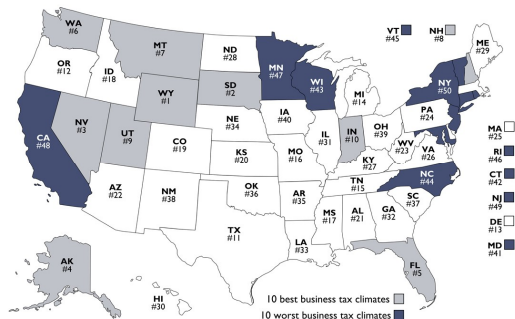


From PEW (2020)

9

# Change in Business Tax Climate

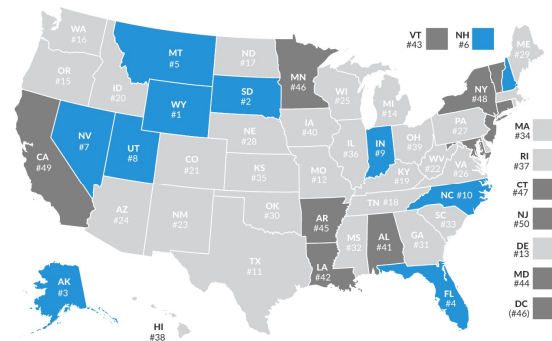
2014 State Business Tax Climate Index



Note: Published October 9, 2013.  
Source: State Business Tax Climate Index

[taxfoundation.org/maps](http://taxfoundation.org/maps)

2021 State Business Tax Climate Index



Note: A rank of 1 is best, 50 is worst. D.C.'s score and rank do not affect other states. The report shows tax systems as of July 1, 2020 (the beginning of Fiscal Year 2021).  
Source: Tax Foundation

TAX FOUNDATION

@TaxFoundation

10

## May Consensus Revenue Forecasts: 2020

The fiscal year is from July 1<sup>st</sup> - June 30<sup>th</sup>.

- The fiscal year that ended on June 30<sup>th</sup>, 2020 is FY20
- The current fiscal year is FY21 and will end on June 30<sup>th</sup>, 2021

Updated forecast for FY20:

- Collections were expected to fall \$1.64 billion (6.6% lower than expected)
- For example, April collections dropped 31.5% from the previous year (lower collections and delayed payments)

Updated forecast for FY21:

- Reduction of \$2.57 billion from previous forecasts (9.9% lower than originally forecasted)

\*It was intended to update the May forecast in the Fall, but given the continued uncertainty, the state proceeded with the May consensus forecasts

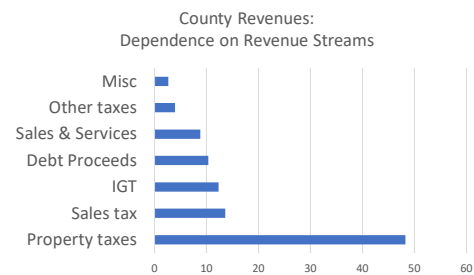
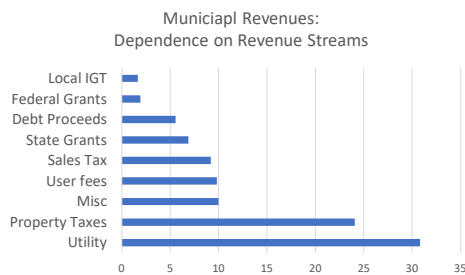
12



What about our local governments?

13

## Local Revenues



14

# Property Taxes

Due in January

- Not impacted for FY20

FY21

- Reassessment process
- Collection rates

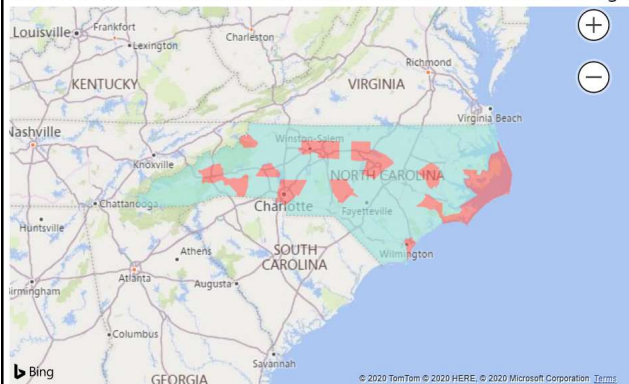
Very stable, typically not very impacted by recessions



15

# Local Sales Taxes

Q4 Local Government Sales Tax Distributions Year-Over-Year % Change



Sales Tax Distributions (FY19-20 YTD)

FY,FQ	Total Distributed	Total % Change Y-O-Y	Difference from Last Year
<b>FY19-20-FQ1</b>	<b>\$956,356,370.75</b>	<b>11.99%</b>	<b>\$102,410,506</b>
August 2019	\$322,204,788.65	17.35%	\$47,646,719
September 2019	\$323,913,920.75	11.45%	\$33,265,808
October 2019	\$310,237,661.35	7.45%	\$21,497,979
<b>FY19-20-FQ2</b>	<b>\$982,752,634.29</b>	<b>5.45%</b>	<b>\$50,807,057</b>
November 2019	\$323,880,599.46	12.98%	\$37,198,265
December 2019	\$319,853,786.46	1.96%	\$6,150,461
January 2020	\$339,018,248.37	2.25%	\$7,458,331
<b>FY19-20-FQ3</b>	<b>\$873,814,502.05</b>	<b>2.29%</b>	<b>\$19,552,163</b>
February 2020	\$276,676,551.84	8.54%	\$21,773,260
March 2020	\$281,591,199.58	7.84%	\$20,465,716
April 2020	\$315,546,750.63	-6.71%	(\$22,686,813)
<b>FY19-20-FQ4</b>	<b>\$962,838,432.80</b>	<b>-1.92%</b>	<b>(\$18,845,646)</b>
May 2020	\$274,448,768.87	-13.30%	(\$42,090,548)
June 2020	\$313,359,256.34	-4.03%	(\$13,155,175)
July 2020	\$375,030,407.59	10.75%	\$36,400,078
<b>FY20-21-FQ1</b>	<b>\$684,244,483.30</b>	<b>5.90%</b>	<b>\$38,125,774</b>
August 2020	\$355,539,986.89	10.35%	\$33,335,198
September 2020	\$328,704,496.41	1.48%	\$4,790,576
<b>Total</b>	<b>\$4,460,006,423.19</b>	<b>4.50%</b>	<b>\$192,049,854</b>

Taken from the North Carolina League of Municipalities (2020)

16



# Local Sales Taxes



Variation across the state

Faster recovery than expected

- Has largely plateaued
- Many factors at play
  - Unemployment insurance
  - Federal stimulus
  - Wayfair

Similar story for food and beverage taxes and occupancy taxes

- Though, in most cases, more impacted than the sales tax

17



## North Carolina's Revenues: Moving Forward

18

# Moving Forward

---

Consulted with Fiscal Research Staff and Legislative Analysis and they note little tax policy proposals currently being considered

COVID-19 was clearly the focus over the last year

19

*Crisis*

危机

*Opportunity and Danger*

- OFT MISREPRESENTATION OF THE CHINESE WORD/CHARACTERS

20



# Opportunity to Rethink Tax Policy



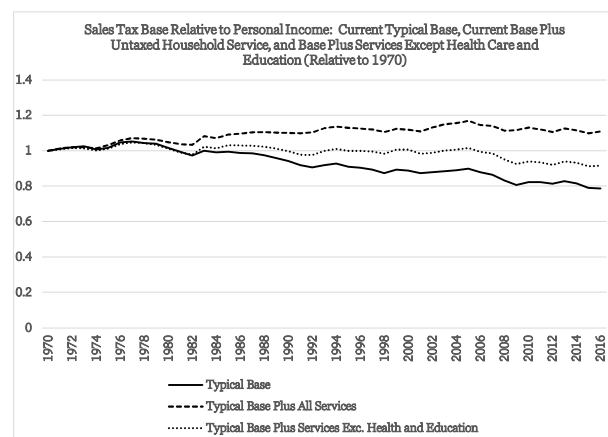
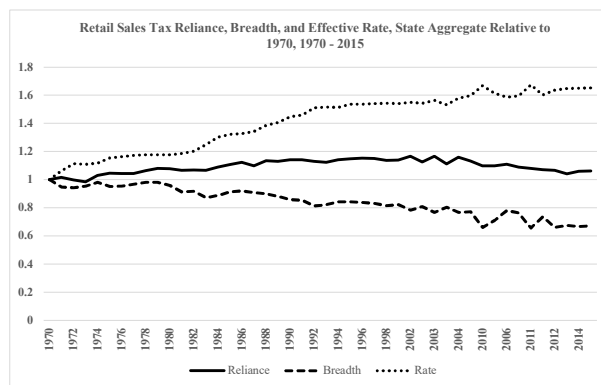
NC had a major tax reform a decade ago

Tax policy innovation

- Taxation of services under the sales tax
- Fuel taxes
- Taxation of the digital economy

21

## Retail Sales Tax



Taken from Mikesell (2018)

22

# Retail Sales Tax on Additional Services

Broaden base to include more services and decrease volatility of revenues

*Food?*

Lots of issues here, e.g.:

Taxation on Business Inputs

Equity

Stability

*Not just about revenue*

Service	Base Increase
Motor vehicle services	5.3%
Recreation services	9.5%
Professional services	3.9%
Personal care and clothing	2.8%
Household maintenance	1.5%
Financial services	11.6%
Insurance (other than life)	5%
Health Care	41.9%
Education	6%

Taken from Awuku-Buda, et al. 2013

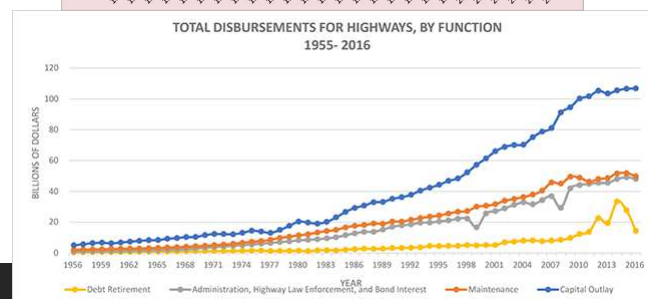
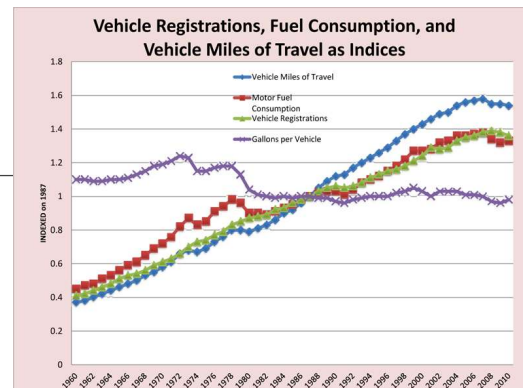
23

## Fuel Taxes

Have been declining since the start of the pandemic

- States like VA, NJ, and SC have increased their motor fuel taxes

Fuel tax rates have been steadily increasing because of lower consumption for long before the pandemic



24

## Fuel Taxes



Rates have steadily been climbing

Cars are becoming increasingly fuel efficient

- Equity and efficiency concerns

Other options out there like a vehicle miles traveled (VMT) fee or increased use of tolls

25

## Cannabis Taxes

Often treated like a windfall

- High compliance costs
- Hard to understand underlying demand and the relationship with the black market
- Tourism related to legalization waning

Revenues, typically, much lower than anticipated

Of course, revenue may not be the primary objective of legalization



26

# Digital Services

## Maryland HB 732 in March 2020

- Tax on digital advertising
- Applies to businesses with >\$1 million in annual gross revenue from digital advertising services in state and >\$100 million worldwide
- Progressive: rate gets higher with higher worldwide revenues
- Overturned by Governor, had previously passed with a veto proof majority, session returns on Jan 13<sup>th</sup>.

## Europe

- UK: Social media platforms, internet search engines, and online marketplaces
- Belgium: Selling user data (proposed)
- Austria: Online advertising
- Italy: Advertising, digital interface, and transmission of user data

27

## Criteria for Taxes

Efficiency  
Equity  
Feasibility  
Stability  
Transparency



28

## Thank You

Please do not hesitate to reach out with any questions or concerns. I look forward to working with you in the future.

Afonso@sog.unc.edu

