

Business Committee on Financing the Future

Statement of Principles: Tax Modernization in North Carolina

North Carolina's existing tax system needs to be overhauled. Our state's economy and population have changed dramatically over the past century, yet our financial systems have not kept pace. As a result, while the overall tax burden is relatively low, revenues are extremely volatile due to an overdependence on the income tax and a severely eroded sales tax base. The sales tax rate is higher than it could be because the tax applies to an increasingly limited range of goods. Personal and corporate income tax rates are above those in surrounding states.

The current financial crisis makes all these problems even worse. If we act now, a comprehensive overhaul will place our state in a much better situation for the future. Other states with similar problems have made, or have proposed, reforms to meet the demands of the future. North Carolina cannot be left behind. We must create a tax system that is competitive, stable, adequate and fair if we are to prosper in the 21st Century economy.

The Business Committee on Financing the Future (BCFTF) believes that a modernized system should be characterized by three basic principles: simplicity, fairness, and a minimal number of exemptions. The goal should be comprehensive change that is revenue neutral, fundamentally pro-growth, and yet offers a variety of improvements when all elements are considered together.

Sales Tax

To decrease the volatility of revenues and to allow a substantial reduction of the tax rate, the BCFTF believes that the sales tax should extend to many services and previously exempted tangible items but not medical services and prescription drugs. The committee supports a compensation mechanism for low-income taxpayers if the sales tax is broadened to include food.

The committee believes that an important purpose of extending the sales tax to include previously exempt goods and services is a reduction in income tax rates.

Income Tax

The BCFTF supports using Federal Adjusted Gross Income as the base for calculating personal state income taxes, with minimal deductions and exemptions. At the same time, the committee also supports reducing marginal individual income tax rates to a level that

is competitive with other southeastern states, while maintaining a progressive rate structure.

The committee recognizes that there may be alternative ways to tax corporations in the place of an income tax, noting that there are other states attempting this. The Committee suggests further study of “best practices” by the appropriate public bodies.

Local Revenues and Responsibilities

The BCFTF believes that all local responsibilities, new and old, should be consistent and should have adequate and appropriate sources of funding. Funding should be provided through a suitable balance of local revenue options and state assistance designed to compensate for variations in the local tax base.

The Committee believes that local government will inevitably benefit from comprehensive tax reform.

Conclusion

The overall purpose of the changes outlined above is to prepare North Carolina for success in a 21st. century economy by providing it with a system of tax and finance that is stable, fair and adequate to needs of future generations.