2006-2008

STATE & LOCAL FISCAL MODERNIZATION STUDY COMMISSION

MINUTES

State and Local Fiscal Modernization Study Commission

2006-2007

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Politics

Will new N.C. fiscal reform commission prompt tax overhaul?

08:49 PM EST on Friday, December 1, 2006

By GARY D. ROBERTSON / Associated Press

RALEIGH, N.C. -- Legislators have heard it all before: North Carolina needs to overhaul its financial structure or risk ruin.

If they don't, economists say, the General Assembly will have to keep raiding trust funds and raising taxes to balance the state budget. Local governments argue they'll have to keep driving up property taxes to pay for Medicaid, transportation and school construction needs.

"It is time to solve these problems," said Sen. David Hoyle, D-Gaston during a meeting of a commission studying the state's fiscal systems. "We need to consider the controversial and not just the comfortable."

But there's a dose of skepticism surrounding the panel. Some observers wonder whether lawmakers or Gov. Mike Easley are willing to make dramatic changes or use up their political capital on contentious issues such as taxing services. The most difficult choices are sure to be framed as unfair to businesses hit with new levies or provide fodder to political opponents.

"I'm at least hopeful, and we'll see about the optimism as we go along," said retired Wachovia Corp. chief executive John Medlin, a commission member.

The State and Local Fiscal Modernization Study Commission is at least the third state panel to take on tax and fiscal reform issues since 2000. Each resulted in incremental changes to squeeze out more money from taxes already on the books. Speakers at the panel's first meeting urged a comprehensive approach.

"To say, 'Let's just take this one piece and turn the dial on one revenue source and all our woes will be over,' that just guarantees that you or others like you will be back in this room three or four years from now on another commission," Roland Stephen with the Institute for Emerging Issues at North Carolina State University told the panel members.

There's more momentum behind this panel than previous ones. The institute, led by former Gov. Jim Hunt, made the state's tax structure the topic of its annual forum in February and held meetings in six cities this fall.

Still, "everybody's got to go into this with skepticism," said Elaine Mejia with N.C. Budget and Tax Center, which monitors budget issues on behalf of low-income residents. "They're running out of popular ways to mask the problem."

While North Carolina's economy is humming along well enough that lawmakers found themselves with $2 billion extra this year, shortcomings in the tax system remain, some people say.

State and local tax revenues originating from sales taxes have fallen in recent decades from 41 percent in 1957 to 35 percent in 2002, although the rate has been raised several times. Internet sales and a shift from manufacturing to service industries in the state are listed among the causes.

Eliminating the food tax in the mid-1990s helped poor people but also gave a break to people who could afford to pay it. Individual income taxes are growing but are volatile and require higher rates to keep growing, researchers say.

One solution, Mejia and others argue, is to tax services such as haircuts, home repairs and legal services.

In exchange, the overall sales tax rate could be lowered -- possibly cut in half from the current 6.75 percent -- without losing any revenues, according to some economists. That way, the state would collect from the growing service industry while lowering taxes for low-income citizens.

But taxing services is tricky and often unpopular.

In 2005, the House attempted to experiment with taxing services by agreeing to tax service contracts and warranties, but the proposal was removed from the final state budget after complaints from bankers and other industries.

"I don't think anybody disagrees that a structure developed during the Depression ... needs some major overhaul," said Paul Stock with the N.C. Bankers Association. "Any industries that feel that they are being disproportionately impacted by the change are going to scream that it's unfair."

Easley believes most people oppose taxing services, but is very interested in the commission's work, said Dan Gerlach, the governor's chief budget adviser.

Gerlach said the governor doesn't want an issue such as taxing services to stop the commission from examining whether state and local governments can do their jobs with only the revenue streams available to them.

Big cities are desperate for more road-building money, while rural communities want help for water and sewer improvements. Counties are required to pay 5 percent of the costs of Medicaid, and having the state take over those payments is the top priority for county commissioners.

The commission is supposed to complete its work by May, but Hoyle and other members already are discussing putting off a final report until 2008. That will make legislators think twice before passing something controversial during an election year. Wait until 2009, and Easley's successor at the Executive Mansion also may defer on such a high-risk venture.

Cumberland County Commissioner Breeden Blackwell, also a commission member, said his colleagues in Raleigh can't be afraid to make tough choices.

"You shouldn't be in elected office if you're not willing to kind of take a stand and sometimes it makes people mad," he said. "Every time I raise my hand at home I don't make everybody happy."

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Your Attention Please...

Posted By Chris Fitzsimon On 4th December 2006 @ 10:25 In Weekly Briefing | No Comments

The Study Commission that All N.C. Progressives Should Be Following

By Rob Schofield

Quick Take:

- Given North Carolina's expanding needs and increasingly obsolete and unfair tax system, the new State and Local Fiscal Modernization Study Commission is an important and timely addition to the state policymaking scene.
- At last week's initial meetings, the Commission got off to a promising start.
- As they proceed, members should keep their focus on long-term reform and avoid the temptation to recommend temporary, quick-fix solutions.

Those who care about making North Carolina a thriving, modern, free and moral state have plenty of battles to fight these days. Whether it's reducing the scandalous high school dropout rate, covering the 1.3 million who lack health insurance, reducing the childcare waiting list of nearly 40,000 children, preserving and cleaning our threatened air, water and land, or building thousands of affordable housing units, it's clear that North Carolina has miles to go before it rests.

Unfortunately, none of these problems can be attacked in a fundamental way, much less conquered, in the present environment. Why? Because each requires a public solution and public solutions cost money – money that state leaders have not yet mustered the know-how, vision or courage to raise.

Enter the State and Local Fiscal Modernization Study Commission. That's a long and bureaucratic name for a group of state leaders who will get together in the months to come to fashion some proposals for remaking a 1930's-era tax system so that it can address the problems of the 21st century.

This is, of course, a formidable task. Lawmakers have attempted similar efforts in the past and had little to show. The issues are complex and many powerful, vested interests are certain to resist ambitious change. To make things even tougher, many state politicians remain wedded to the notion that the only way to assess the tax system is by seeing how it "compares" to other states – usually in the southeast. Still others remain mired in the mindset that all taxes (as well as any effort to expand our public problem solving commitment) are inherently evil.

The Reasons to Act

Despite the challenges and causes for pessimism, there are simply too many good reasons "on the ground" for moving ahead with the Fiscal Modernization Study. Here a three:

<!--[if !supportLists]-->

1. **The current tax system is out of date.** Though it was ahead of its time in many ways 70 years ago, North Carolina's basic tax structures has changed little since the 1930's. Today, the system does only an average job of capturing a fair share of economic activity in our modern, service-oriented economy. The classic example of this obsolescence, of course, involves the goods-oriented sales tax, which despite repeated rate increases generates a lower share of total state revenues than it did 50 years ago.

2. **The current tax system is increasingly unfair.** Next month, the Washington, DC-based Institute on Taxation and Economic Policy will release its newest "Who Pays?" report – a nationwide index that documents the way in which each of the states in the country apportions the responsibility for paying for state and local government. In 2003, "Who Pays?" showed that North Carolina had a markedly regressive system – that is, lower and middle income households paid a higher percentage of their income in state and local taxes than did the wealthiest. In an era of expanding income and wealth gaps, not only is such a phenomenon morally perverse, it is also a part of a kind of vicious circle in which government constantly raises regressive taxes (e.g., sales, cigarettes, and the lottery) that disproportionately affect the very people whose incomes are stagnant.
3. <!--[if !supportLists]-->**The current tax system is inadequate**. Despite the aspersions of anti-government ideologues, the vast majority of state and local government spending in North Carolina goes to pay for essential, core services like education, roads, public safety and health care for the elderly and disabled. As noted above, many basic needs of the state's rapidly growing and "graying" population remain unaddressed. That North Carolina leaders might actually have the revenues available to undertake any kinds of new or bold initiatives that would usher a real sea change in the quality of life for average citizens is unimaginable in the present structure.

A Cautious, but Promising, Start

The Fiscal Modernization Study Commission convened for the first time last Wednesday and Thursday. During the two-day session, members listened to a series of presentations from an array of academics and analysts who sought to describe North Carolina's fiscal "lay of the land." (Note that readers can access the various PowerPoint presentations and written reports by clicking here, scrolling down to the very bottom of the page, and clicking on "State and Local Fiscal Modernization Study Commission").

In general, speakers and members seemed to acknowledge the importance of the mission that confronts the group. It was noted, for instance, that the group would not offer a comprehensive report until May, 2008 – something that seems eminently reasonable if there is to be sufficient time to develop any truly significant recommendations for change.

The presentations themselves did a generally solid job of apprising Commission members of some of the key challenges that confront the state. Professor Jim Johnson of the Kenan-Flagler Business School explained the remarkable demographic changes that will confront the state as its population ages and becomes more racially and ethnically diverse. Mike Walden of N.C. State noted the importance of avoiding the trap of measuring tax "burdens" between states without accounting for the crucial societal benefits that public spending can produce. It will augur well for the group if it can sustain the serious and analytical tone of the first two days.

Quick Fix Temptations

If there was any cause for concern during the first two days, it was the hint dropped by some that the Commission might serve as a vehicle for promoting a controversial proposal during the 2007 legislative session on the vexing issue of how to relieve counties of their responsibility for helping to pay for Medicaid expenditures. Currently, North Carolina is the only state to require local government to contribute a fixed share of the Medicaid bill. This requirement can be an enormous cost – particularly for smaller, poorer counties.

For years now, lawmakers have discussed various schemes for lifting this local government burden. One proposal that has gained some favor of late would involve a "swap" in which locals would be relieved of their Medicaid bill (along with a portion of the sales tax revenue that is currently earmarked for counties). In exchange, counties would be given authority to raise a new penny on the sales tax on a county by county basis.

While superficially appealing, the sales tax-Medicaid swap represents precisely the kind of short-term thinking that is at the root of many of the problems that the Commission was empowered to address. By raising the regressive sales tax once again without expanding its base (i.e., the services and products subject to the tax) lawmakers would simply be placing a temporary and regressive bandage on a problem that requires a much more comprehensive solution.

Going Forward

In the months ahead, the Fiscal Modernization Commission has the potential to be one of the most important study groups established by state lawmakers in many years. Those who care about building the state's capacity to undertake new and meaningful public solutions to the challenges it confronts would do well to pay close attention *and* to urge the Commission to keep its eyes on the prize.

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Posted on Sun, Dec. 03, 2006

EDITORIALS

Paying the freight

State-local panel begins overdue look at fiscal reforms

A 28-member panel went to work Wednesday afternoon in Raleigh on a subject that bears on everyone's future: Re-examining the way local and state government share responsibilities for service and how they pay for them. The State and Local Fiscal Modernization Study Commission hopes to come up with some common-sense ways to rebalance the formulas governing who pays for what services, and how.

It's off to a solid if sobering start after hearing from a dozen policy experts on how North Carolina developed its current revenue system in the Depression, how it has tinkered with that system over the years, how demographics will change the state and how various governments share responsibilities for streets, roads, schools, courts, prisons, jails, health care and other vital services.

The commission's co-chair, Sen. David Hoyle of Gastonia, told members it should contemplate practical recommendations for the 2008 legislative session. Ben Russo of the UNC Charlotte economic department underscored that point in a review of previous federal and state reform efforts. He cited studies showing comprehensive tax reform rarely is achieved, but there are lessons that will help. They including understanding the forces at play, developing an overall vision for reform, balancing principles for reform and seeking bipartisan consensus.

Those may be helpful when the panel's work gets down to figuring out what legislators will approve. Other studies have also set out with ambitious goals. The last major one -- headed by Z. Smith Reynolds Foundation President Tom Ross and staffed by the governor's top fiscal policy advisor, Dan Gerlach -- resulted in a number of important incremental changes that closed loopholes and broadened the tax base. Both Judge Ross and Mr. Gerlach are members of the new panel, which Mr. Gerlach cochairs. Rep. Becky Carney, a Charlotte Democrat, and Rep. Jeff Barnhart, R-Cabarrus, are House cochairs.

This study is a joint effort of the legislative and executive branches as well as representatives of local governments and the business sector. It was moved along in part by the desire of Senate Democratic Leader Tony Rand to help alleviate counties' share of Medicaid costs by having the state pay for more of it. The governor's office, meanwhile, saw it as an ideal time to re-examine the broader balance of responsibilities among state and local governments.

It's no accident the name of the panel mentions neither "tax" nor "reform." Those are rhetorical speed bumps that may get in the way of the overall discussion of more important questions. Local governments need a broader menu of options to pay for services. State government needs a way to examine overall spending and decide what's the best use of public resources.

There's a lot riding on the commission's work. It's off to a good start as it works to modernize a government finance system that is, after all, three-quarters of a century old.

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Point of View:

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Getting N.C. taxes on target

MICHAEL L. WALDEN

RALEIGH - From 1920 to 1933 North Carolina completely revamped its fiscal system. A state income tax and sales tax were enacted, while the state property tax was removed. After many counties found it difficult to fund infrastructure and essential services, the state increased its financing and control over roads, public schools and prisons.

Now, a new commission – the State and Local Fiscal Modernization Study Commission – will begin meeting this month to consider today's fiscal situation. This is appropriate because there are many parallels between the North Carolina of 80 years ago and the North Carolina of today.

Then, the economy was changing from agriculture to manufacturing, people were moving to the cities and the boom times of the 1920s were followed by the Depression of the 1930s.

Today, the economy is changing from manufacturing to services, people are moving to the suburbs and exurbs, and the boom times of the 1990s have been followed by the uncertain times of the 2000s.

Just as in the past, there are four main issues facing the state's new fiscal commission:

• What's the right tax base? The tax base is simply what is taxed, such as individual and corporate income, retail sales and property. Several specific questions arise about today's tax base.

What's the best combination of the tax bases to use? For example, in recent years a larger proportion of revenue has come from the individual income base. Also, the relative size of the sales tax base has been shrinking, as more retail spending has shifted to services, which are largely untaxed, from goods, which are taxed. Should new tax bases be considered and existing ones altered or scrapped?

• What's the right tax rate? The tax rate is the percent of the tax base taken in taxes. One major question, heard most about the individual income tax, is whether one rate should apply for all taxpayers, or should several rates apply based on some characteristic of the taxpayer, such as income. If higher-income taxpayers are taxed at higher rates, as they are now, could this be

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counterproductive, reducing the state's ability to attract higher-paying jobs?

There's also often a tradeoff between the size of the tax base and the level of tax rates. The same revenue can be derived from a broader tax base and a low rate as from a narrower tax base and higher rate. Which is better?

A broad base/low rate system reduces the degree of interference of the tax system in private decision-making. On the other hand, a narrower base, with more deductions and exemptions, allows public decision-makers more influence over directing private spending to areas the public sector may desire.

• What are the right tax options for local governments? The taxing ability of local governments (counties and municipalities) in North Carolina is controlled by the General Assembly. Local governments have relatively complete control only over the property tax. Levying new taxes or changing other existing taxes requires legislative approval.

Is it time to loosen the strings on local governments and allow them more options in their taxing authority, to reduce reliance on or perhaps replace the property tax? Should local governments have the power, at their discretion, to levy, for example, a local gasoline tax, increase the local sales tax or consider a local income tax? Or, should the state strive to keep separate tax bases reserved for the state and for local governments?

• What's the right division of functions between the state and local governments?

This issue represents a constant tug between two goals that often are in conflict. On the one hand, citizens want some standard level of public services to be available regardless of where they live in the state. Public education, highways and public safety are three good examples.

But on the other hand, citizens want the ability to adjust those service levels to meet local differences and needs, and to see their tax dollars spent locally. The first goal is often accomplished through statewide financing and control, while the second is better met with local decision-making and locally raised funds. What's the best resolution of these twin goals?

The work of the new fiscal commission in North Carolina is not necessarily to recommend increases or decreases in taxes. Instead, its work is more fundamental. Just as 80 years ago, it's time to take a hard look at both the funding and functions of North Carolina's fiscal system and decide if a new structure is needed for a new century.

(Economist Michael L. Walden is a William Neal Reynolds distinguished professor at N.C. State University. He is working on a book about the modern North Carolina economy.)

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Drifting Off Course?

Posted By Chris Fitzsimon On 19th March 2007 @ 12:13 In Weekly Briefing | No Comments

Fiscal Modernization Study Needs to Get Back on Track

By Rob Schofield

Quick Take:

- Right now, key state policymakers and private citizens are participating in what could be one of the most important legislative studies in decades.
- The State and Local Fiscal Modernization Study Commission has the opportunity to make the kinds of recommendations that could secure North Carolina's future for generations.
- Four months into its work, however, the Commission seems at-risk of losing its focus. Now is the time for the group to get things back on track.

A New Engine for Government

Tax policy is what makes government go. To be a participant in state public policy debates without paying attention to tax policy is like ignoring the engine when building an automobile. Today in North Carolina, some important people are having a discussion about the kind of engine that will power state government in the coming decades.

The group in question is the State and Local Fiscal Modernization Study Commission. Established last fall and now four months into its work, the Commission is charged with designing a reliable, long lasting, and "fuel efficient" engine for state government. The idea is to build a new motor that will be powerful and efficient enough to propel all 8.5 million North Carolinians (12 million+ by 2030) into a brighter future without placing too much stress on any one part of the "vehicle."

The chief political challenge confronting members of the Commission at this point seems to be similar to the dilemma that has confronted carmakers in Detroit in recent years: Should they cash in right away with tricked up versions of old technology that look glitzy and go fast, but that are unreliable and bad for the common good? Or should they invest for the long-term by spending a little more to develop safe, dependable, "green" vehicles that hold greater promise for profits (and the planet) in the long run?

The Work So Far: Cut Progressive Taxes?

As reported here last December, the guiding idea behind the Commission was to develop plans for remaking a 1930's-era tax system so that it can address the problems of the 21st century – that is, to fashion a strong, but efficient, and built-to-last engine for modern state government. Some of the most important subcommittee reports last week, however, sounded distressingly Hummer-like in design and intent – quick-fixes that benefit a few in the short run but that avoid the kinds of real, long-term changes and sacrifices that are necessary for sustained and shared progress. The prime example of this shortsighted drift was the failure of any of the subcommittee reports to make a serious effort to address, much less promote, "progressivity."

As has been documented repeatedly by the experts at the N.C. Budget and Tax Center, one of the chief

shortcomings of North Carolina's current fiscal system is its regressive nature. According to the best available data (an update is expected in the very near future), North Carolina's tax code places a disproportionate responsibility on low and middle income households. Indeed, the poorest 20% of North Carolinians pay a much higher share of their incomes (10.6%) in state and local taxes combined than the richest 1% (6.1%). Middle class taxpayers (10%) have much more in common with the poor than the wealthy. Corporate taxes are even lower and so riddled with loopholes that some large, highly profitable corporations may well manage to avoid paying taxes at all.

This regressiveness is a key indicator of an obsolete system that's gone to seed. Not only is the system under the increasing control of powerful, moneyed interests able to secure preferential treatment for themselves, but it also given over to a pernicious cycle in which taxes and rates are regularly raised on the very people whose incomes have been left lagging in recent years by the changing economy.

Unfortunately, in their reports last week, subcommittees showed little willingness to tackle this central problem – particularly the subcommittee designated to examine the state's most progressive revenue stream– the income tax. Like a car company slapping some sporty wheels on an obsolete Oldsmobile or Plymouth, the subcommittee recommended doing precisely the opposite of what reality and common sense dictate, it proposed *slashing* personal income taxes – particularly on the wealthy.

Though the group softened its proposal with some suggested technical changes, it added even more weight to its jalopy by proposing a one-fifth cut in the tax on corporate profits and an end to the gift and estates taxes. Total bottom line loss to the state from the subcommittee's efforts: **a cool $1.8 billion annually** – most of it targeted for the pockets of the state's wealthiest citizens.

Can a Sales Tax Expansion Fill the Gap?

To make up for the dramatic revenue losses that its proposals would bring about, Income Tax Subcommittee members stated that they were relying upon another of the Commission's subgroups (the one looking at sales taxes) the fill the hole. Here, the notion was that by markedly expanding the economic transactions to which sales taxes are applied, the state could actually lower rates and fill any revenue gaps that might occur.

And indeed, academics assigned to the Commission dutifully presented computer models which confirmed the theoretical possibility of such a swap. It was reported that if the state expanded the sales tax to *all* services (food, health care, legal services, apartment rentals – *everything*), it could cut the state's portion of the sales tax rate from 4.25% all the way to 1.85% and still come out $2.7 billion ahead on an annual basis. The expanded sales tax base would also allow counties to use dramatically lower rates as well. Add to this mix the possibility of the long-sought handoff of the counties' $500 million and growing, annual Medicaid bill to the state (and maybe even some local property tax cuts) and one gets a pretty good idea of the kind of back of the envelope calculations with which Commission members were toying.

Where to Go From Here?

While the sheer grandiosity of the Commission's discussions last week may not bode well for its near-term prospects in the General Assembly, there is every reason to take the group's discussions seriously. The Commission's membership is formidable and the ostensible purpose of the Commission – to modernize the state fiscal system – remains a laudable and popular objective. Expansion of the sales tax base is also a widely accepted and worthy objective and some of the Commission's other subgroups have also delved into important and worthwhile discussions of local taxes, infrastructure and the

division of program responsibilities between state and local government.

Still, as of last week's meeting, the Commission was drifting rather far afield from its original mission. Members of the Income Tax subcommittee, in particular, devoted significant time to a narrow and flawed discussion of "competitiveness" (as in "North Carolina needs to lower its top income tax rates in order to remain 'competitive' with other states"). Not only is such a discussion nowhere in the Commission's charge (see pages 35-37), it's based on a faulty assumption. North Carolina's population is bursting with new in-migrants for whom tax rates are obviously not a factor. Meanwhile, a new Ernst & Young study found that the state had the lowest overall business tax rate in the country.

A better place to address the state's "competitiveness" would have been in terms of the quality of its public education system, its natural environment and infrastructure, or any number of factors that militate *against* a huge income tax cut. While they were at it, the group might also have closely examined the overall impact of its proposals on progressivity. In response to a question last week from Commission Co-chair Dan Gerlach of the Governor's office, one of the university-based staff assigned to the Commission was forced to admit that their complex computer models have yet to address progressivity at all – an obvious and huge omission.

If the Fiscal Modernization Commission is to get back on track, it's essential that members return to basics. To do this they will have to remember and acknowledge that the state needs a 21st-century tax engine that works for all North Carolinians – not a spruced up version of that creaky old gas guzzling V-8, trickledown economics.

Article printed from NC Policy Watch with Chris Fitzsimon: **http://www.ncpolicywatch.com/cms**

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The Business Journal of the Greater Triad Area - March 13, 2007
http://triad.bizjournals.com/triad/stories/2007/03/12/daily15.html

THE BUSINESS JOURNAL
SERVING THE GREATER TRIAD AREA

BUSINESS PULSE SURVEY: Gun control now?

Ernst & Young: NC has low biz-tax rate

The Business Journal of the Greater Triad Area - March 13, 2007

North Carolina businesses have a low tax burden, according to a study by tax experts with Ernst & Young prepared for the Council on State Taxation.

That study shows that North Carolina's state and local applicable business tax rate is 3.9 percent, tied with four others for lowest in the nation.

The 50-state study used public information to estimate the business share of a variety of 26 taxes at the state and local government levels. The study provides policy makers with a "factual basis to evaluate the current state and local tax burden," said Douglas Lindholm, president and executive director of the Council on State Taxation.

The study includes estimates of taxes paid by major industry groups, such as property tax, sales tax, excise and gross receipts taxes, corporate income and franchise taxes. The share of taxes paid is determined by a state's overall tax system, the structure of its economy and business tax features that may provide a competitive advantage or disadvantage in attracting and retaining business, such as incentives, according to a news release from Ernst & Young.

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ITEP Institute on Taxation and Economic Policy
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EMBARGOED FOR RELEASE ON
TUESDAY, JANUARY 7, 2003 AT 10:00 AM
CONTACT: Bob McIntyre, 202/737-4315

North Carolina Taxes Hit Poor & Middle Class Much Harder than the Wealthy

Low- and middle-income families in North Carolina pay a much higher share of their income in state and local taxes than do the richest North Carolina taxpayers, according to a new study by the Institute on Taxation & Economic Policy.

"State and local governments are being called upon to take on more and more responsibilities," said Robert S. McIntyre, ITEP's tax policy director and lead author of the study, titled *Who Pays? A Distributional Analysis of the Tax Systems in All 50 States*. "Unfortunately, when it comes to paying for services, North Carolina has an unfair tax system."

North Carolina's Tax Code: Tax the Poor & Middle Class More Than the Wealthy

When all North Carolina taxes are totaled up, the study found that:

- The state and local tax rate on the best off one percent of North Carolina families—with average incomes of $813,000—is 8.9% before accounting for the tax savings from federal itemized deductions. After the federal offset, the effective tax rate is only 6.1%.
- The average tax rate on families in the middle of the income distribution—those earning between $25,000 and $39,000—is 10.1% before the federal offset and 10% after, one and a half times the effective rate the richest pay.
- But the tax rate on the poorest North Carolina families—those earning less than $15,000 —is the highest of all. At 10.6%, it is a much higher share than that of the very wealthy.

"North Carolina's income tax fails to offset the regressivity of its sales and excise taxes, giving the state a regressive tax system," McIntyre said. "Taxes ought to be based on people's ability to pay them, which means that the share of income paid in taxes should rise as income grows, not fall as is the case in North Carolina."

MORE . . .

Tax Regressivity Has Grown Since 1989

The study also examined the impact of changes in the regressivity of North Carolina taxes since 1989, when the last cycle of state government shortfalls began. The study's findings include:

- Exempting groceries from the sales tax, a progressive change, failed to offset rising property and income tax burdens on the poorest families.
- Overall, the lowest-income North Carolina taxpayers saw their taxes go up, while everyone else, especially the best-off people, got a tax cut.

"Low- and middle-income taxpayers in North Carolina continue to shoulder the highest tax burdens in the state," said McIntyre. "As lawmakers consider budget-balancing strategies in 2003, they should remember that their past actions have served to shift a greater share of the tax burden onto low-income taxpayers."

Two pages of tables detailing the North Carolina findings of the study follow

The Institute on Taxation and Economic Policy is a nonpartisan Washington-based research group. The full *Who Pays?* report is available in PDF format at www.itepnet.org. Printed copies can be ordered by calling ITEP at 202-737-4315.

Who Pays? examines the tax systems of all 50 states and the District of Columbia, using the Institute on Taxation & Economic Policy Microsimulation Tax Model. The ITEP Model is similar in methodology and data sources to the elaborate computer models used by the U.S. Treasury and the congressional Joint Committee on Taxation, except that the ITEP Model adds state-by-state estimating capabilities.

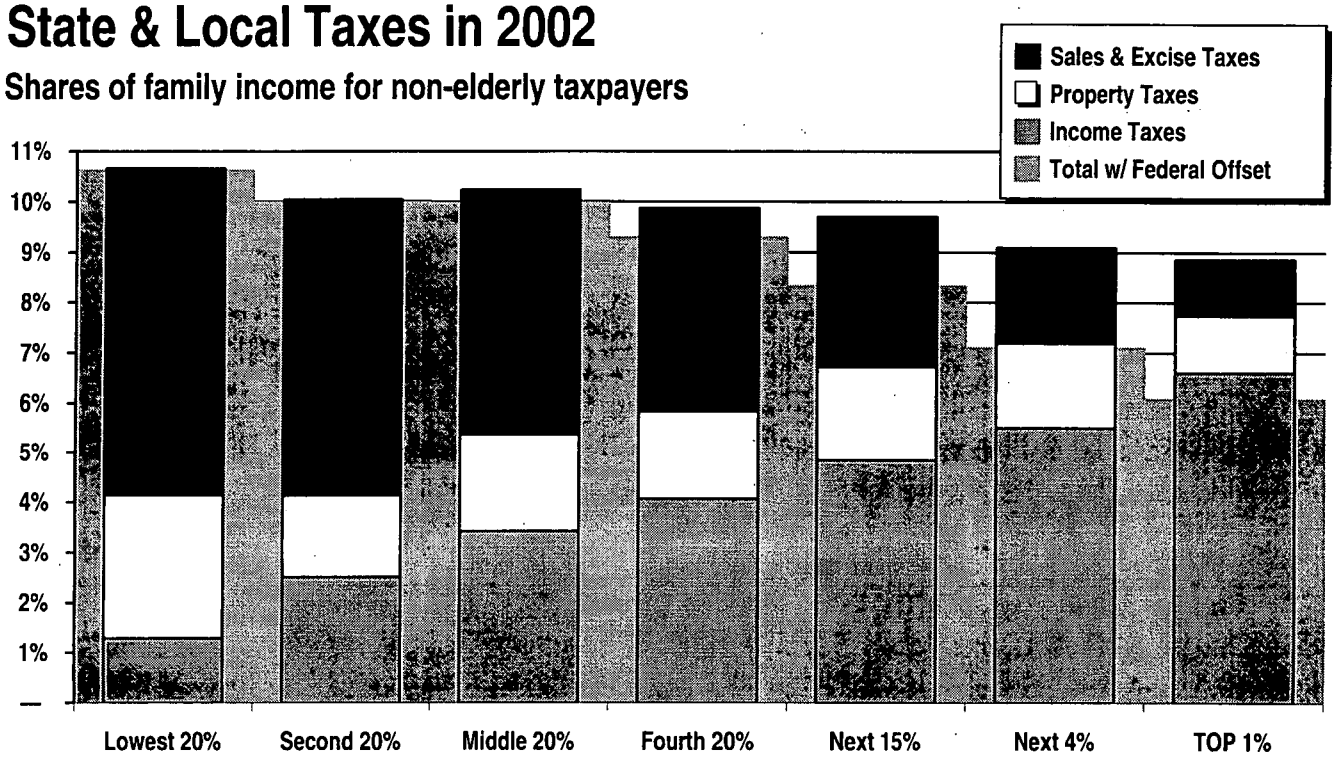
The findings published in the study detail state and local taxes paid by non-elderly couples and individuals. The study includes all major state and local taxes: personal and corporate income taxes, property taxes, and sales and excise taxes.

MORE . . .

North Carolina

State & Local Taxes in 2002

Shares of family income for non-elderly taxpayers



Income Group	Lowest 20%	Second 20%	Middle 20%	Fourth 20%	Top 20%		
					Next 15%	Next 4%	TOP 1%
Income Range	Less than $15,000	$15,000 – $25,000	$25,000 – $39,000	$39,000 – $64,000	$64,000 – $124,000	$124,000 – $333,000	$333,000 or more
Average Income in Group	$9,100	$19,700	$31,300	$50,100	$84,800	$177,000	$814,000
Sales & Excise Taxes	**6.5%**	**5.9%**	**4.9%**	**4.0%**	**3.0%**	**1.9%**	**1.1%**
General Sales—Individuals	3.6%	3.3%	2.9%	2.5%	1.9%	1.2%	0.8%
Other Sales & Excise—Ind.	1.3%	1.1%	0.9%	0.7%	0.5%	0.3%	0.1%
Sales & Excise on Business	1.7%	1.5%	1.1%	0.9%	0.7%	0.4%	0.3%
Property Taxes	**2.9%**	**1.6%**	**1.9%**	**1.8%**	**1.9%**	**1.7%**	**1.1%**
Property Taxes on Families	2.8%	1.6%	1.9%	1.7%	1.8%	1.5%	0.7%
Other Property Taxes	0.0%	0.0%	0.1%	0.1%	0.1%	0.1%	0.4%
Income Taxes	**1.3%**	**2.5%**	**3.4%**	**4.1%**	**4.8%**	**5.5%**	**6.6%**
Personal Income Tax	1.3%	2.5%	3.4%	4.0%	4.8%	5.4%	6.3%
Corporate Income Tax	0.0%	0.0%	0.1%	0.1%	0.1%	0.1%	0.3%
TOTAL TAXES	**10.7%**	**10.1%**	**10.2%**	**9.9%**	**9.7%**	**9.1%**	**8.9%**
Federal Deduction Offset	–0.0%	–0.0%	–0.2%	–0.6%	–1.4%	–2.0%	–2.8%
TOTAL AFTER OFFSET	**10.6%**	**10.0%**	**10.0%**	**9.3%**	**8.3%**	**7.1%**	**6.1%**

Note: Table shows 2002 tax law at 2000 income levels.

North Carolina Tax Trends

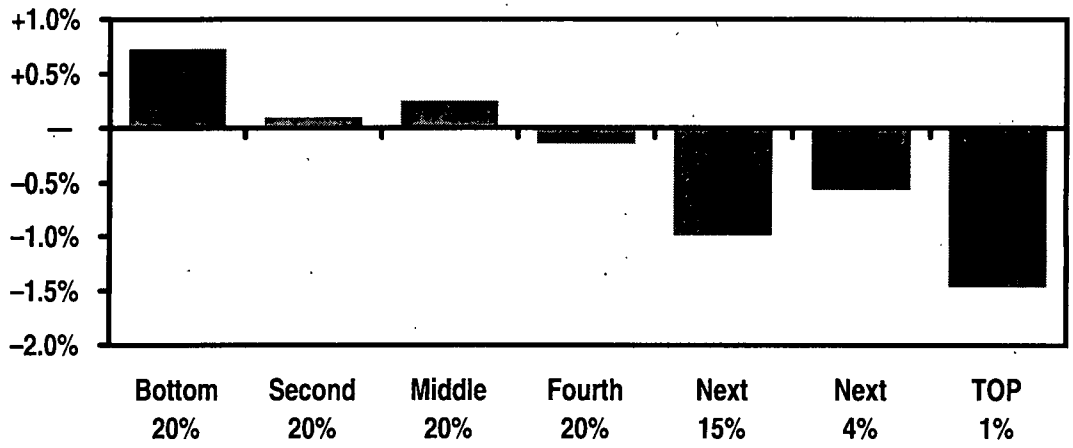
Progressive Features

- ✔ Per-person credit
- ✔ Dependent care credit
- ✔ Groceries exempt from state sales tax

Regressive Features

- ✘ Credits not refundable

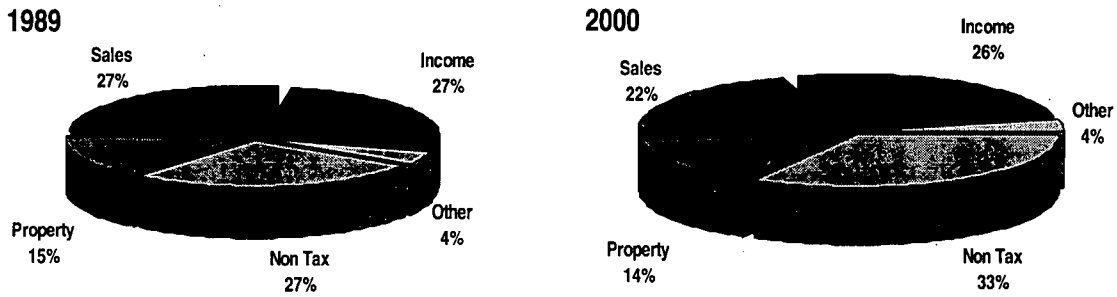
Changes in Taxes as Shares of Income, 1989 – 2002



	Bottom 20%	Second 20%	Middle 20%	Fourth 20%	Top 20%		
					Next 15%	Next 4%	TOP 1%
Sales & Excise	–0.6%	–0.5%	–0.4%	–0.3%	–0.3%	–0.2%	–0.0%
Property	+0.8%	+0.2%	+0.5%	+0.1%	–0.8%	–0.7%	–1.1%
Income	+0.5%	+0.4%	+0.3%	+0.3%	+0.4%	+0.6%	+0.6%
Federal Offset	–0.0%	–0.0%	–0.1%	–0.2%	–0.3%	–0.3%	–0.9%
Overall Change	+0.7%	+0.1%	+0.2%	–0.1%	–1.0%	–0.6%	–1.5%

The exemption of groceries from the state sales tax was a progressive cut that offset hikes of 1% in the state sales tax and .5% in most local sales taxes. A new top income tax bracket added in 1991, targeted at those making over $50,000 ($100,000 married), was a progressive rate hike, while the lack of indexing of the personal exemption was an implicit regressive tax increase.

Composition of Revenues



Source: Government Finances, US Department of Census

State and Local Fiscal Modernization Study Commission

November 28, 2006
AGENDA

1:00 –1:20 PM	**Welcome Remarks** **Introduction of Members and Staff**	**Chairs and Members**
1:20 – 1:40 PM	**Charge, Goals and Structure of Commission**	**Rep. Carney, Rep. Barnhart, Sen. Hoyle, Sen. Rand, Dan Gerlach**

The Commission is charged with examining state and local revenue sharing and taxing authority, the division of responsibility for providing infrastructure, public education, Medicaid and other needs, reviewing the state's tax code and making recommendations to modernize it, and recommending changes in the sharing of revenues and responsibilities including a permanent financing strategy to eliminate the county share of Medicaid.

1:40 – 2:20 PM	**The Changing Face of North Carolina**	**James Johnson, Professor of Management, Sociology and Public Policy, UNC-Chapel Hill**

As a state, we are growing, aging, and becoming both more diverse and metropolitan. These changes have important implications for our future.

[illegible]0 – 3:00 PM	**The History of State and Local Taxes in North Carolina: Changes in Sources and Burdens**	**Roby Sawyers, Professor of Accountin[illegible] NC State University**

North Carolina's basic state and local tax structure has changed little since the 1930s. However, the state has increasingly relied on the individual income tax and charges and fees as the importance of other sources of revenue have declined.

3:00 – 3:15 PM	**Break**	
3:15 – 3:45 PM	**Tax Burden Measurements and Comparison to Other States**	**Mike Walden, William Neal Reynolds Distinguished Professor, NC State University**

A state's tax burden can be an important factor in the location decisions made by individuals and businesses. The ability of a state to compete for new businesses and to retain existing businesses may be inhibited to the extent that a state's tax burden is higher than, or perceived to be higher than, that of neighboring states. How should tax burdens be measured and where does North Carolina stand in comparison to other states?

3:45 – 4:30 PM	**Overview of State and Local Division of Responsibilities and Funding**	**Roland Stephen, Assistant Director for Research and Policy, Institute for Emerging Issues**

The purpose of this presentation is to outline the major spending obligations placed on state and local government as well as the sources of funding for those responsibilities. A more detailed discussion of particular areas will take place on the morning of November 29th.

4:30 – 5:00 PM	**Best Practices and Comparison with Other States**	**Maurice Mongkuo, Professor of Public Administration, Fayetteville State University**

How does North Carolina compare to other states with respect to the responsibility for and funding of services provided by the state and local governments?

6:00 – 8:30 PM	**Reception and Dinner**

The reception and dinner are sponsored by the Z. Smith Reynolds Foundation.

VISITOR REGISTRATION SHEET

State & Local Fiscal Modernization — Nov. 28, 2006

Name of Committee — Date

VISITORS: PLEASE SIGN IN BELOW AND RETURN TO DeANNE MANGUM

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Judy Rhyne	NC Assoc. of County Commissioners
Carolyn Meiners	NC Association of County Commr
Jennifer Willis	Wake County Govt.
Owen Franklin	NC League of Municipalities
Jan Winters	Gaston County
Amy Stevens	Lee County Commissioner
[illegible]	CWMTF
Mary Klenz	League of Women Voters NC

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Bill Hester	Southern Wine & Spirits
Michael Hansor	NCAE
Karl Smith	IEI / School of Government
Rolan Stephen	IEI /
Diane Cherry	IEI
Rebecca Troutman	NCACC
DAVID THOMPSON	NCACC
Kara Millonzi	School of Government
Bill Kopp	N Hanover Co. Commissioner
Doug Shackelford	UNC - CH
Jason King	N.C. Association of County Commissioners

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Becki Gray	Civitas Institute
R. Paul Wilms	NCHBA

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Lisa Martin	NC Home Builders
Andy Ellen	NCRMA
DAVID BARNES	Poyner + Spruill
BILL SCOGGIN	KCLA
Cam Coates	BDDHL
LISA NOLEN	GOVERNOR'S OFFICE
Marie Duncan	Smith Anderson
ELLIS HANKINS	NCLM
Anita Watkins	NCLM
Allen Bost	NCAE
DANIEL BAUM	KCLH

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Name of Committee — Date

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NAME	FIRM OR AGENCY AND ADDRESS
Jeffrey Starkweather	N.C. Smart Growth Alliance jeffreystarkweather@earthlink.net
Michael Lavender	McDowell Co. Commission 48 Hawksview Dr. Marion NC 28752
Paul Stoll	NCBA
John Goodman	NCCBI
G. Simon	Duke Univ Health System
Bill McCulay	PSNC Energy
Anthony Allen	NCACC
Betty Turner	Bank of America
Elaine Mejia	NC Budget & Tax Center
Meg Gray	NC Budget & Tax Ctr
Rob Schofield	NC Policy Watch

UNIVERSITY OF NORTH CAROLINA AT CHAPEL HILL
KENAN-FLAGLER BUSINESS SCHOOL

The Changing Face of North Carolina

James H. Johnson, Jr.
William Rand Kenan, Jr. Distinguished Professor of Management
Kenan-Flagler Business School
Director, Urban Investment Strategies Center
Frank Hawkins Kenan Institute of Private Enterprise
University of North Carolina at Chapel Hill

November 2006

Overview

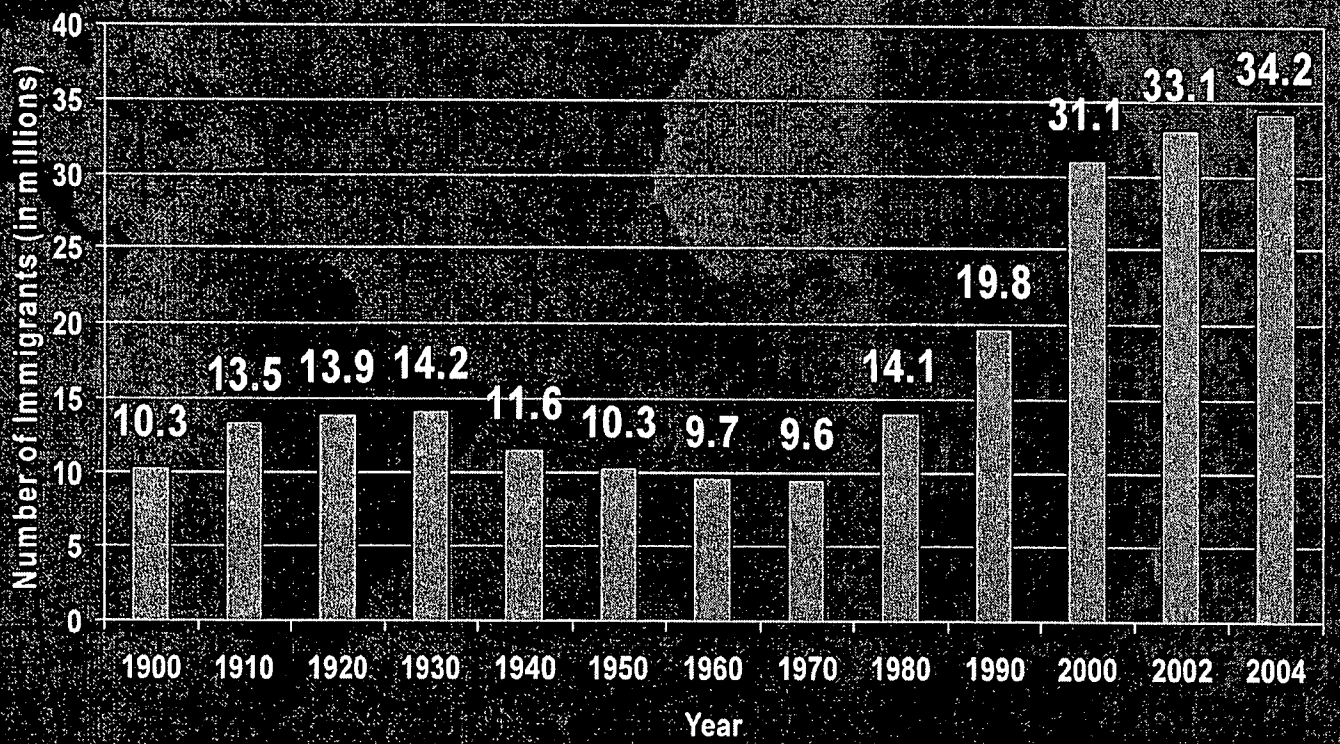
I. The "Browning" and "Greying" of America

II. A Demographic Lens on North Carolina

III. Implications and Challenges

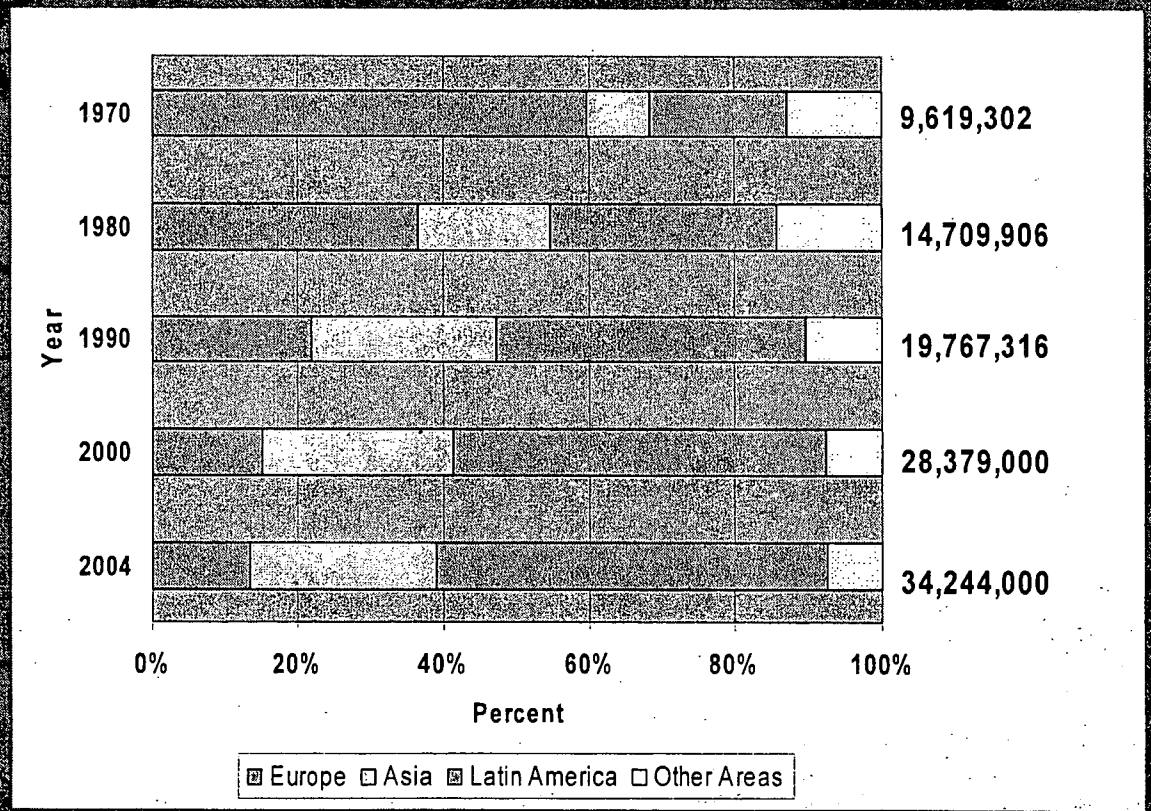
IV. Discussion

Immigration Population, 1900-2004



Source: Center for Immigration Studies; U.S. Census Bureau, Current Population Survey

World Region of Birth for U.S. Population, 1970-2004



Source: Historical Census Statistics on the Foreign-Born Population of the United States: 1850-1990; Current Population Survey

Population Estimations by Race/Ethnicity, 1988-2050

Group	Percent Change
All Races	50%
Whites	29%
Blacks	94%
Native Americans	109%
Hispanics	238%
Asians/Pacific Islanders	412%

America's Color Adjustment

Race/Ethnicity	1995	2050
White	73.6	52.8
Blacks	12.0	13.5
Hispanics	10.2	24.5
Asian	3.3	8.2
American Indian	0.7	0.9

Median Age by Race and Gender, 2000

Race/Ethnicity	Both	Male	Female
U.S.	35.3	34.0	36.5
White Alone	37.7	36.5	38.9
White, Not Hispanic	38.6	37.4	39.8
Black Alone	30.2	28.5	31.7
Hispanic/Latino	25.8	25.4	26.3
Asian Alone/Native Hawaiian	32.7	31.7	33.8
American Indian/Alaska Native	28.0	27.2	28.9
Other Pacific Islander	27.5	27.0	28.1
Some Other Race	24.6	24.5	24.6
Two or More Races	22.7	22.3	23.1

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Fertility Indicators for Women, 15-44, by Nativity and Hispanic Origin

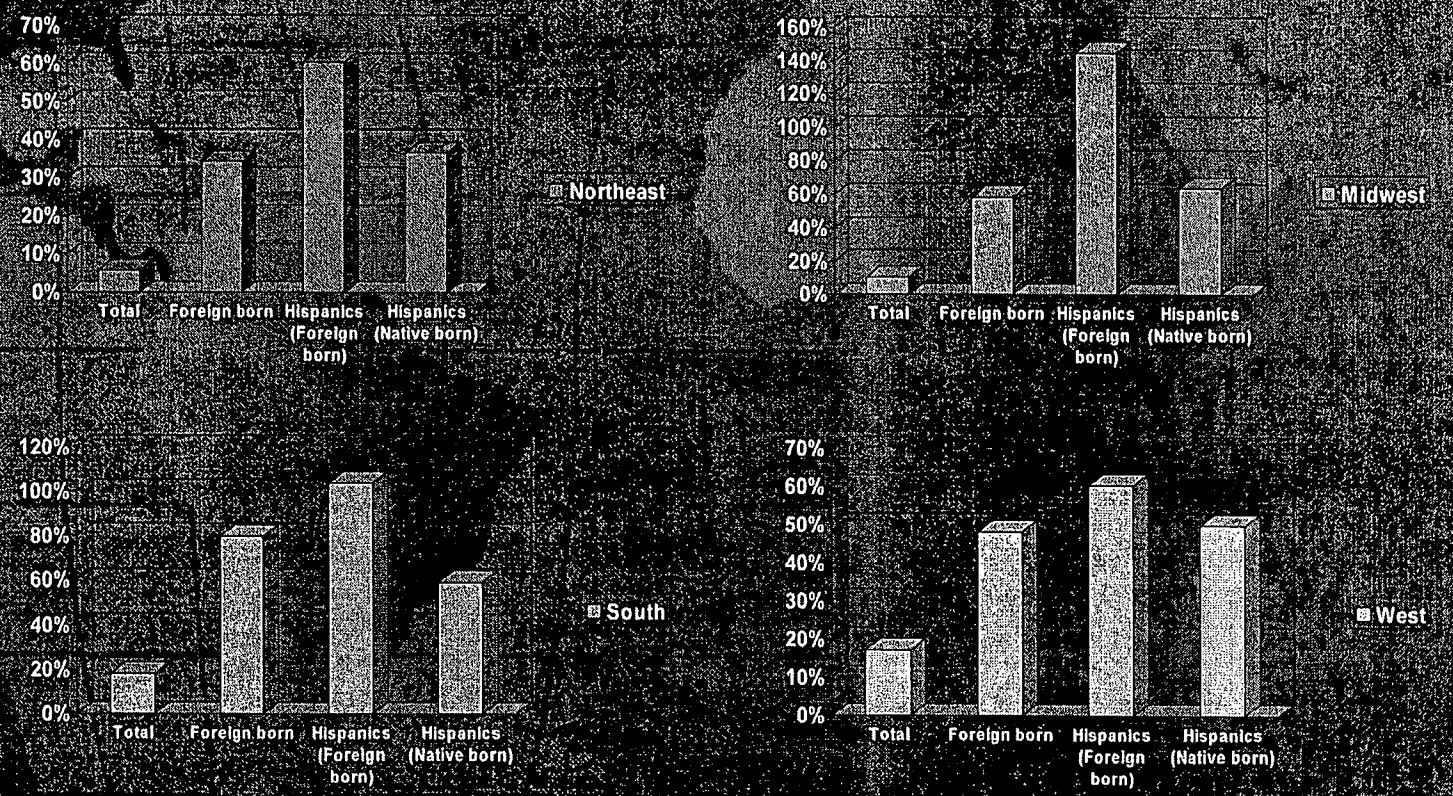
Nativity	Births Per 1,000 Women
Native-born	61.5
Hispanic (of any race)	79.8
Not Hispanic	59.9
Foreign-born	85.4
Hispanic (of any race)	112.3
Not Hispanic	60.8

U.S. Total and Foreign Born Population Change, 1990-2000

	2000 Population	Absolute Change 1990-2000	% Change 1990-2000
Total	281,243,499	33,323,643	13.4%
Foreign Born	32,989,429	11,472,676	53.3%
Hispanic (Foreign Born)	14,410,703	6,331,264	78.4%
Hispanic (Native Born)	20,760,734	7,057,303	51.5%

Source: Public Use Microdata Samples, 1990 and 2000 (5% samples)

Percent Change in Total and Foreign Born Population, by Region, 1990-2000



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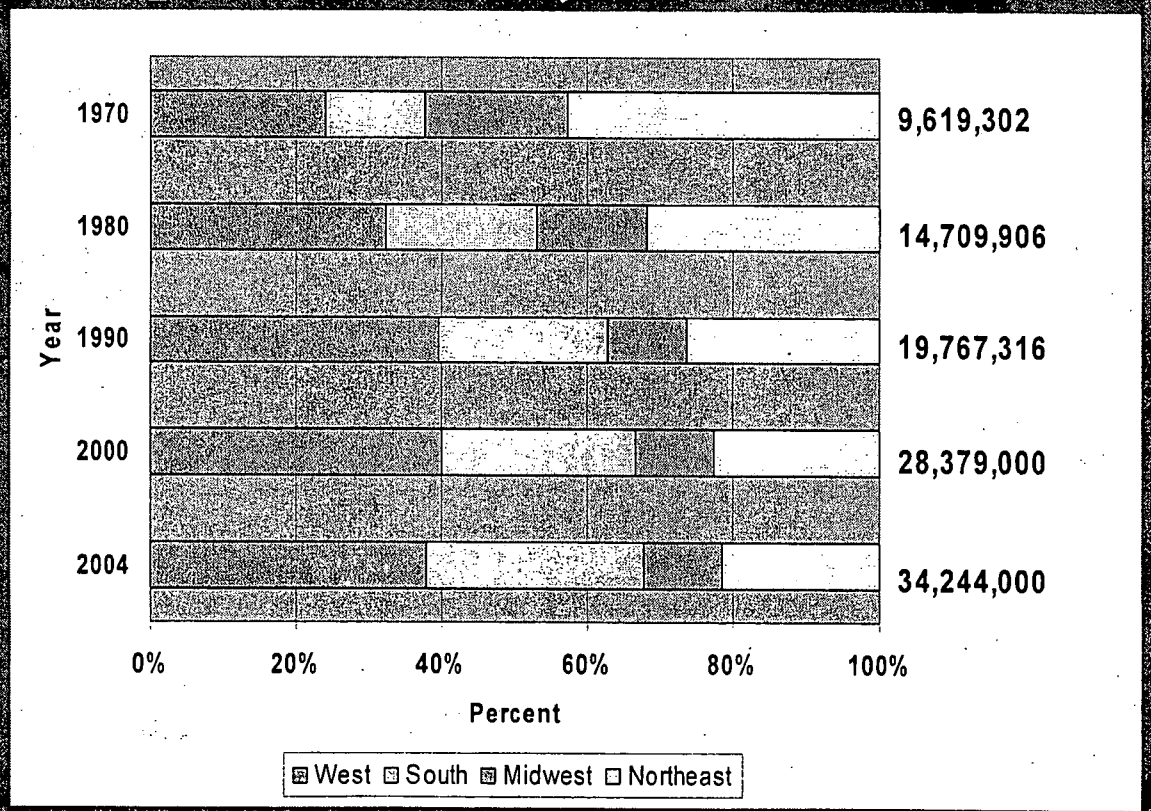
Change in Regional Distribution of Foreign Born Population, 1970-2004



Source: Historical Census Statistics on the Foreign-Born Population of the United States: 1850-1990; Current Population Survey

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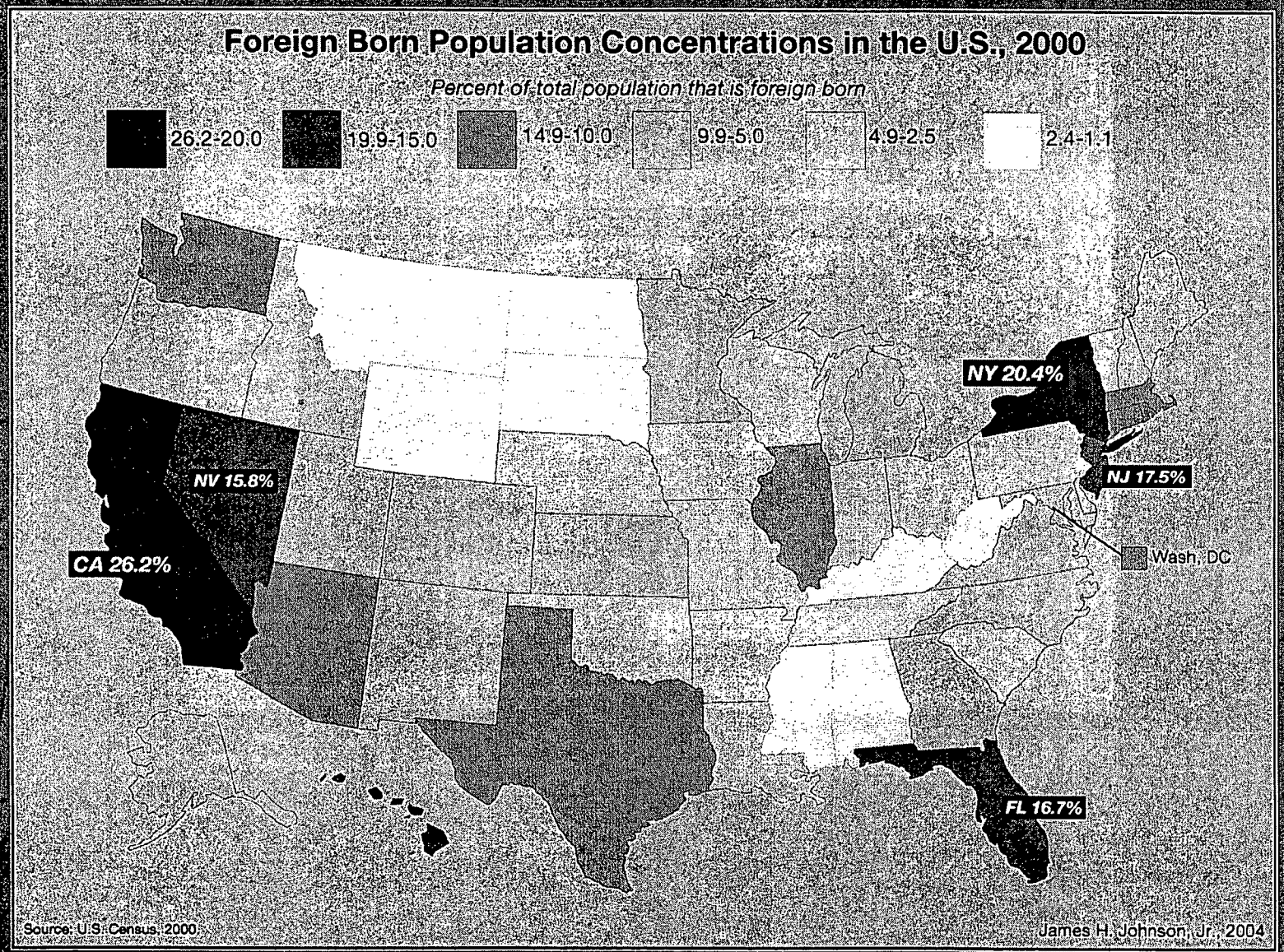
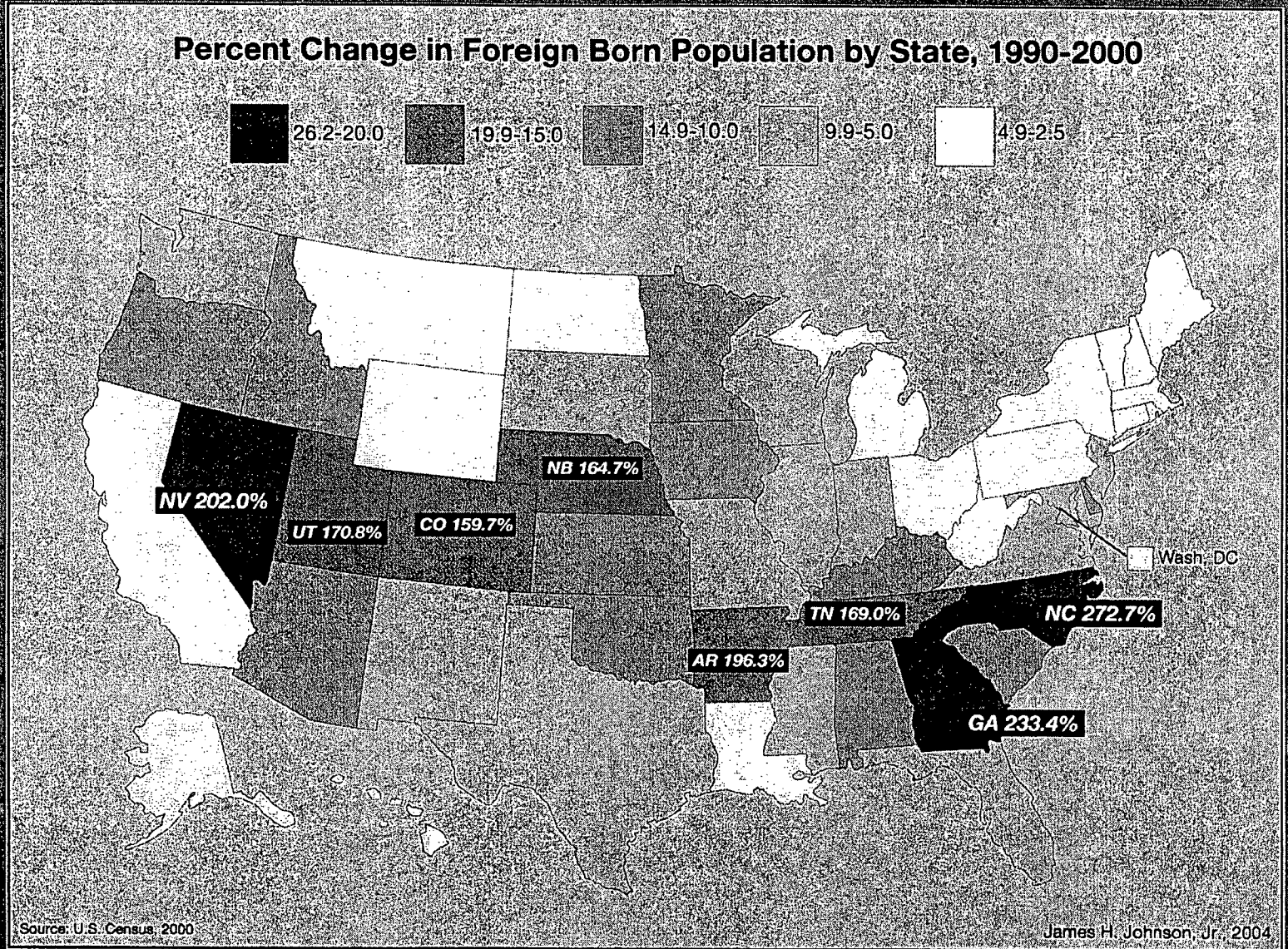
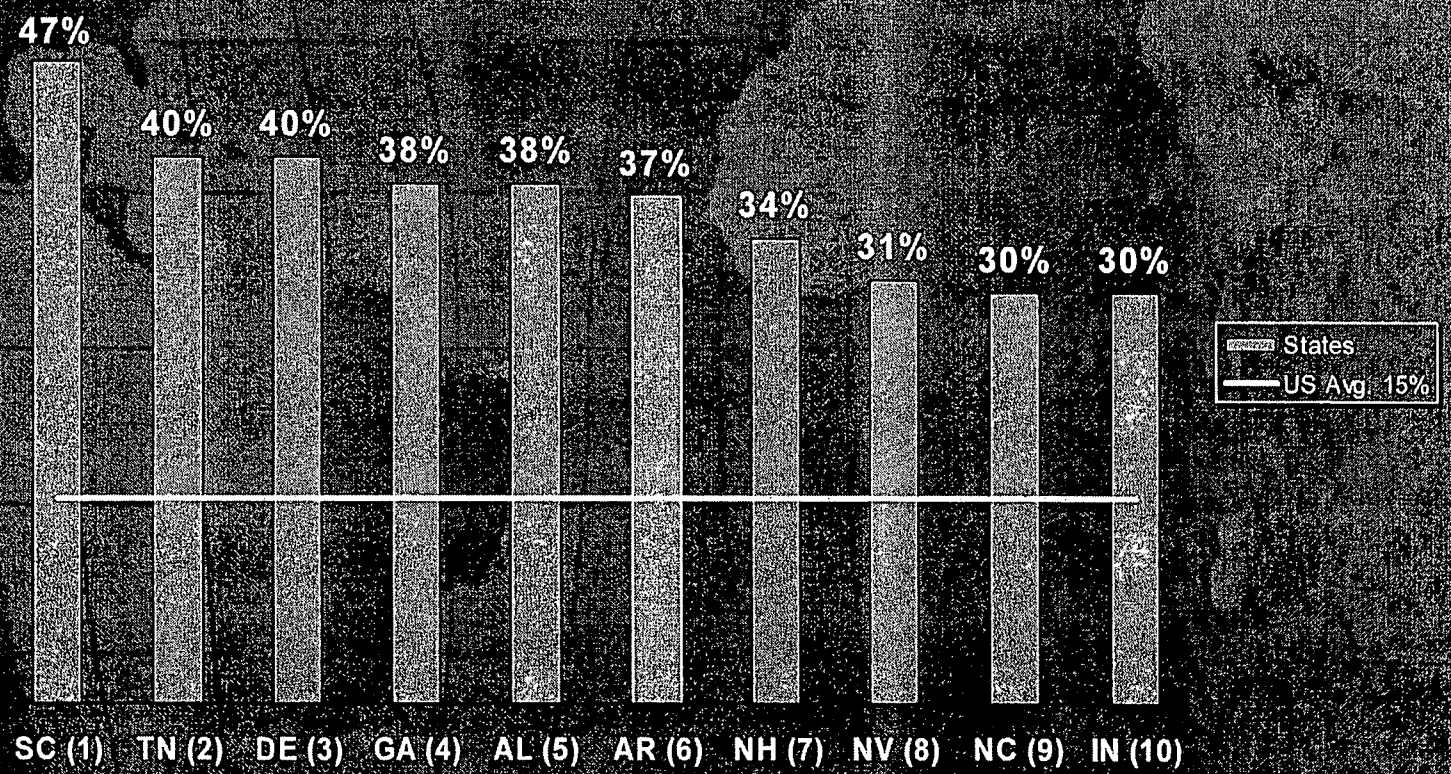

Foreign Born Population Concentrations in the U.S., 2000
Percent of total population that is foreign born
26.2-20.0
19.9-15.0
14.9-10.0
9.9-5.0
4.9-2.5
2.4-1.1
NY 20.4%
NJ 17.5%
NV 15.8%
CA 26.2%
FL 16.7%
Wash. DC
Source: U.S. Census, 2000
James H. Johnson, Jr., 2004


Percent Change in Foreign Born Population by State, 1990-2000
26.2-20.0
19.9-15.0
14.9-10.0
9.9-5.0
4.9-2.5
NV 202.0%
UT 170.8%
CO 159.7%
NB 164.7%
TN 169.0%
AR 196.3%
NC 272.7%
GA 233.4%
Wash. DC
Source: U.S. Census, 2000
James H. Johnson, Jr., 2004

States with Fastest Growing Immigrant Populations, 2000-2005



Source: 2000 U.S. Census, 2005 American Community Survey

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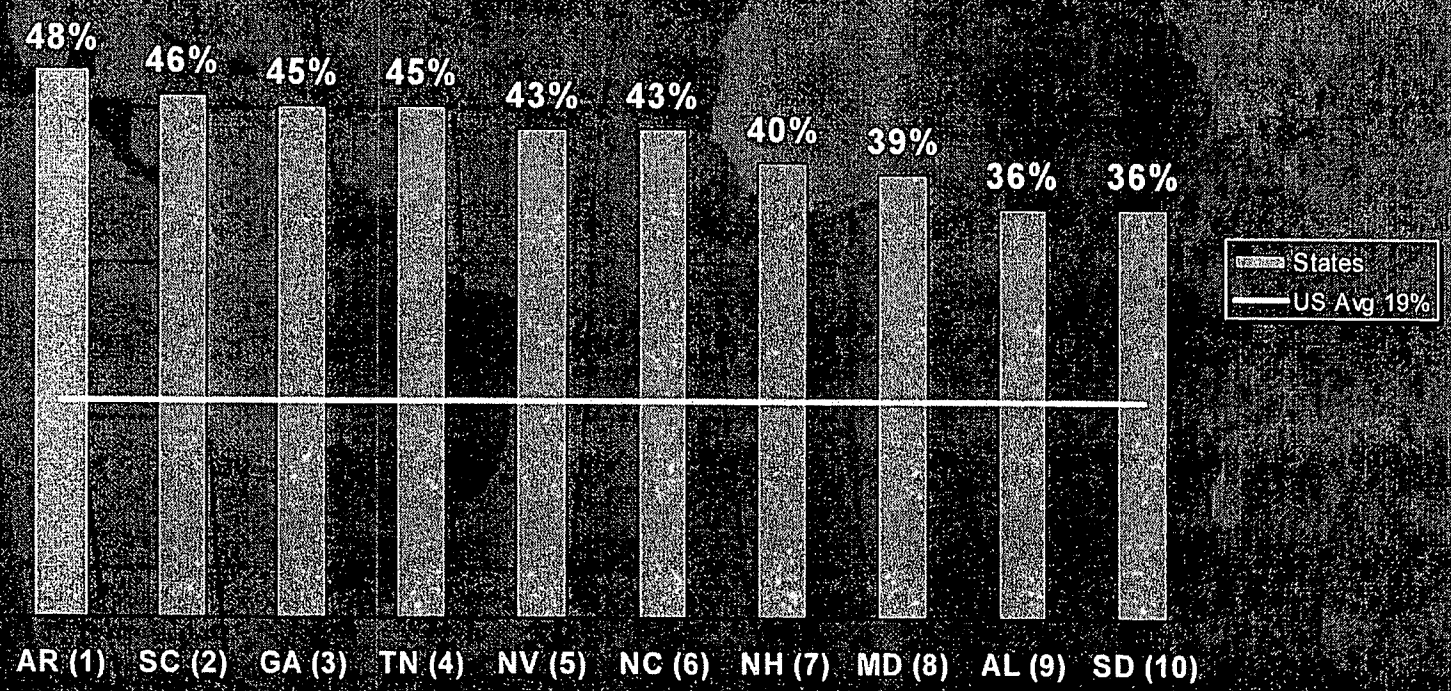
States with Fastest Growing Hispanic Populations, 2000-2005



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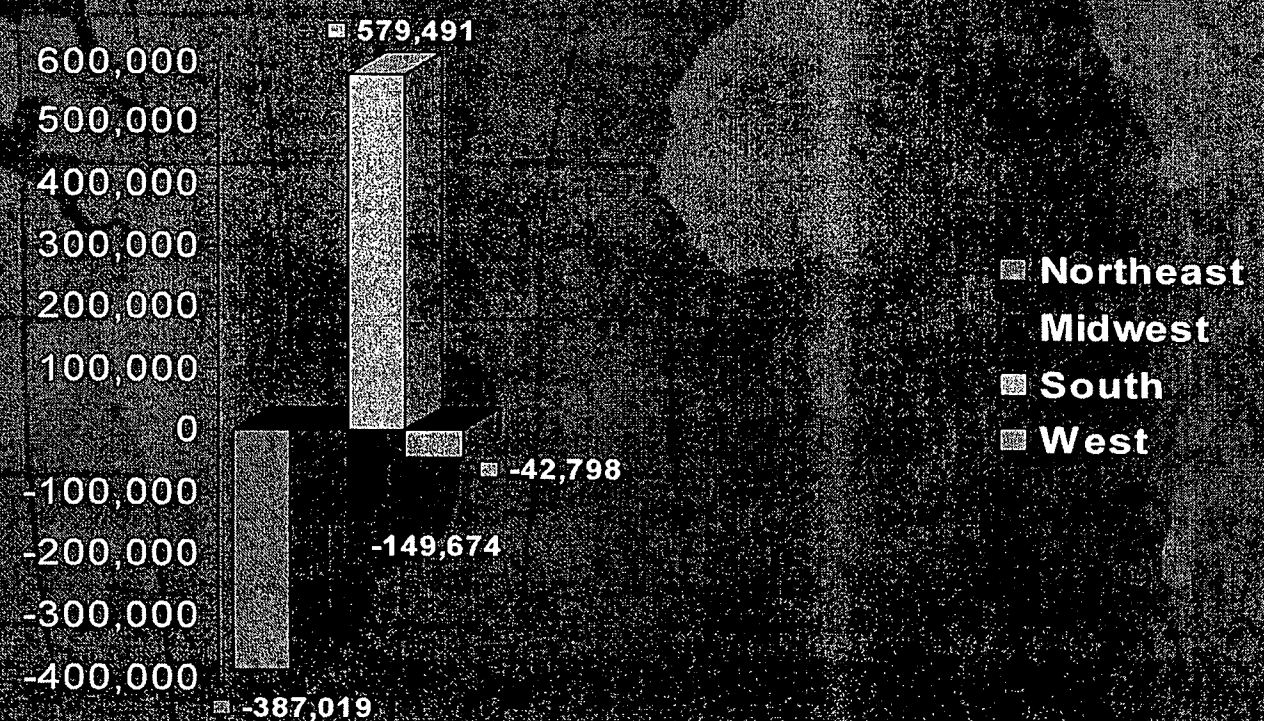
Source: 2000 U.S. Census

Blacks Return to the South
Change in Population, 1990-2000



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Net Population Change in North Carolina by Race and Hispanic or Latino Origin, 1990-2000

Race and Hispanic or Latino	2000 Population	Net Gain 1990-2000	Percent Change
Total	8,049,313	1,420,676	21.4%
White	5,804,656	796,237	15.9%
Black or African American	1,737,545	281,222	19.3%
American Indian or Alaska Native	99,551	19,396	24.2%
Asian	113,689	63,719	127.5%
Native Hawaiian and other Pacific Islander	3,983	1,787	81.4%
Some other race	186,629	155,127	492.4%
Hispanic or Latino (of any race)	*378,963*	*302,237*	*393.9%*

November 2006

Source: U.S. Bureau of the Census, American Fact Finder.

Net Population Change in North Carolina Race and Hispanic or Latino Origin, 2000-2004

Race and Hispanic or Latino	2004 Population	Net Gain 2000-2004	Percent Change
Total	8,270,028	220,715	2.7%
White	6,004,307	199,651	3.4%
Black or African American	1,754,897	17,352	1.0%
American Indian or Alaska Native	86,434	-13,117	-13.2%
Asian	139,422	25,722	22.6%
Native Hawaiian and other Pacific Islander	4,528	545	13.7%
Some Other Race	166,627	-20,002	-10.7%
Hispanic or Latino (of any race)	*506,206*	*127,243*	*33.6%*

Source: US Census Bureau, 2004 American Community Survey, 2000 US Census

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North Carolina Births by Race/Ethnicity, 1990 and 2003

	1990	2003	% Change
All Races	10,525	118,308	13.2
White	69,512	70,458	1.4
Black	30,726	27,170	-11.6
American Indian	1,516	1,637	8.0
Asian/Pacific Islander	1,052	3,106	195.2
Hispanic	*1,754*	*16,084*	*817.0*

Source: Centers for Disease Control, National Vital Statistics Reports, 1990 and 2003

Net Change in Total and Hispanic Enrollment in NC Public Schools, 1985-2004

Years[1]	Total Enrollment Change	Hispanic Enrollment Change	% Change
1985-1990	-3,558	4,795	
1990-1995	90,378	13,769	15.2
1995-2000	95,472	33,933	35.6
2000-2004	78,755	45,148	57.3

Source: North Carolina Department of Public Instruction, 2005

[1] As of September of each school year

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Hispanic Resident Costs and Benefits to State, 2004

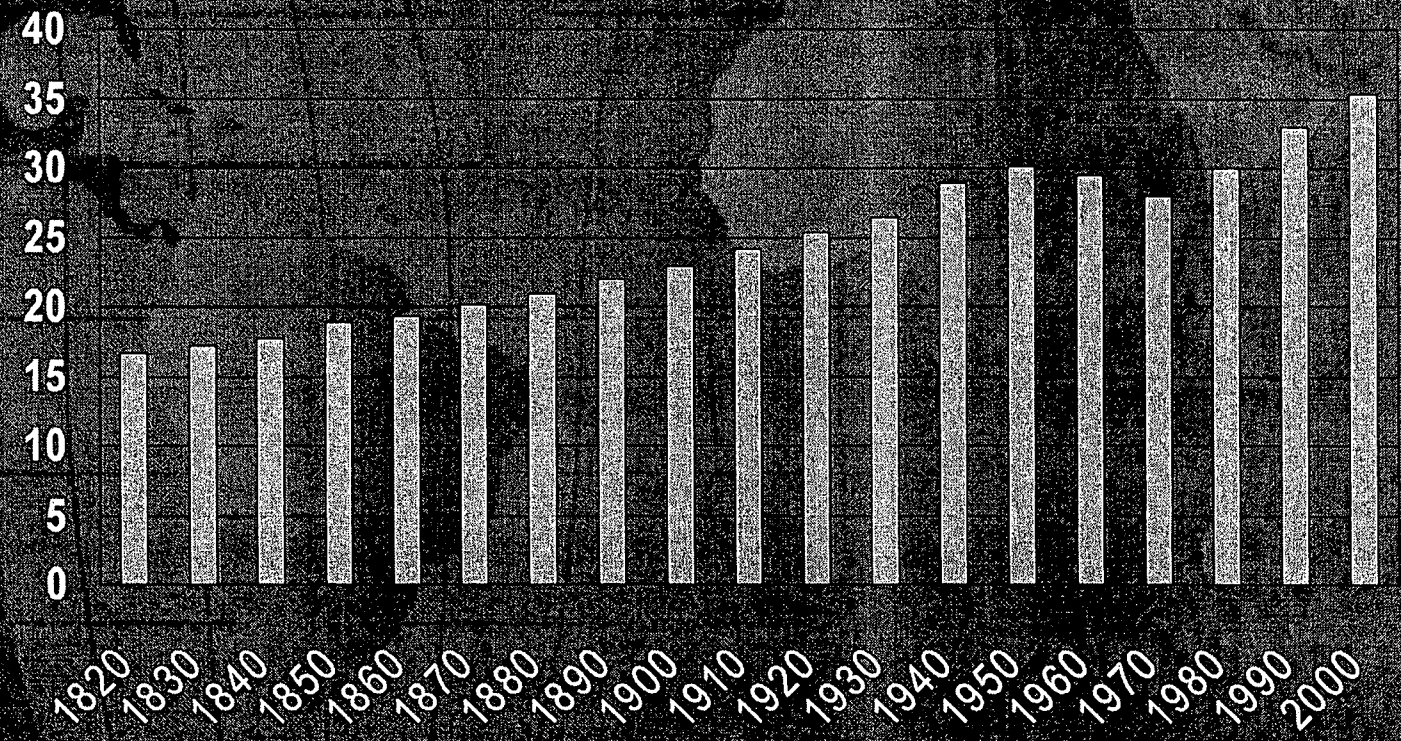
Total Estimated Major Public Costs	$816,559,000
Total Estimated Taxes Contributed	$755,520,000
Net Cost to State	$61,039,000
($102 per Hispanic resident)	

- Broader Economic Benefits:
  - $9.2 billion in total NC Business Revenue
  - 89,000 additional jobs
  - $1.9 billion in overall statewide private-sector wage savings (1.4% of NC's private sector wage bill)
  - Increased labor output for NC industries

NC Construction Industry Example of Competitive Output, 2004

- 29 percent of all NC construction workers are Hispanic
- If Hispanic workers are withdrawn, loss of:
  - $10 billion in value of construction
  - $2.7 billion in construction materials and labor
  - $145 million in equipment and building rentals
  - 27,000 housing units not built
  - $980 million in labor-cost savings

Aging America: U.S. Median Age, 1820-2000



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Source: U.S. Census Bureau, San Francisco Chronicle

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Absolute and Relative Change in the Gender/Age Composition of the U.S. Population, 1990-2000

Gender/Age	2000 Population	Net Change 1990-2000	% Change 1990-2000
Total	281,421,906	32,712,033	13.2%
Male	138,053,563	16,814,145	13.9%
Female	143,368,343	15,897,888	12.5%
Age 18-34	67,035,178	-2,878,520	-4.1%
Age 35-54	*82,826,479*	*20,024,490*	*31.9%*
Age 55-64	24,274,684	3,126,761	14.8%
Age 65+	34,991,753	3,749,922	12.0%

Source: U.S. Bureau of Census (2000)

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Absolute and Relative Change in the Gender/Age Composition of the U.S. Population, 2000-2005

Gender/Age	2005 Population	Net Change 2000-2005	% Change 2000-2005
Total	292,261,463	10,839,557	3.9%
Male	143,203,258	5,149,695	3.7%
Female	149,058,205	5,689,862	4.0%
Age 18-34	65,962,739	-1,072,439	-1.6%
Age 35-54	*86,399,619*	*3,573,140*	*4.3%*
Age 55-64	30,528,710	6,254,026	25.8%
Age 65+	35,199,481	207,728	0.6%

November 2006

Source: 2000 U.S. Census; 2005 American Community Survey, PUMS Estimates

Absolute and Relative Change in the Gender/Age Composition of the North Carolina Population, 1990-2000

Gender/Age	2000 Population	Net Change 1990-2000	Percent Change 1990-2000
Total	8,049,313	1,420,676	21.4%
Male	3,942,695	728,405	22.6%
Female	4,106,618	692,271	20.3%
Age 18-34	2,020,236	95,308	4.9%
Age 35-54	*2,372,270*	*665,954*	*39.0%*
Age 55-64	723,712	136,809	23.3%
Age 65+	969,048	164,707	20.5%

Source: U.S. Bureau of Census (2000)

Absolute and Relative Change in the Gender/Age Composition of the North Carolina Population, 2000-2004

Gender/Age	2004 Population	Net Change 2000-2004	% Change 2000-2004
Total	8,270,028	220,715	2.7%
Male	4,018,899	76,204	1.9%
Female	4,251,129	144,511	3.5%
Age 18-34	1,901,539	-118,697	-5.9%
Age 35-54	*2,448,345*	*76,075*	*3.2%*
Age 55-64	846,476	122,764	17.0%
Age 65+	965,612	-3,436	-0.4%

Source: 2000 U.S. Census, 2004 American Community Survey

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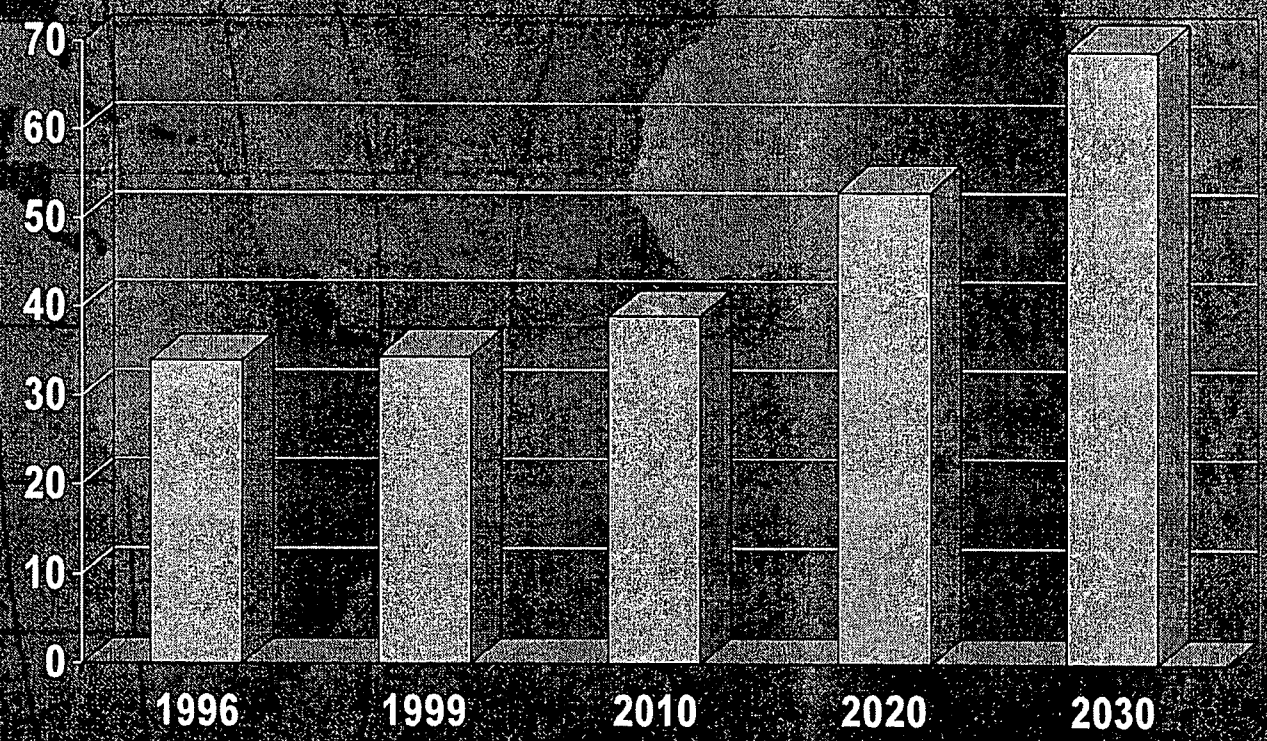
Age Profile of UNC-CH Faculty, 2002

Employee Type	Number	< 40	40-59	60+	Average Age
Tenured/Tenure Track	1,821	310	1,213	298	50.4
(%)	(100)	(17)	(67)	(16)	
Fixed Term	870	254	570	46	45.5
(%)	(100)	(29)	(66)	(5)	
Total	2,691	564	1,783	344	48.8
(%)	(100)	(21)	(66)	(13)	

Source: Institutional Research - University of North Carolina at Chapel Hill

Aging America: U.S. Population 65 and older, selected years, 1996-2030 *(in millions)*



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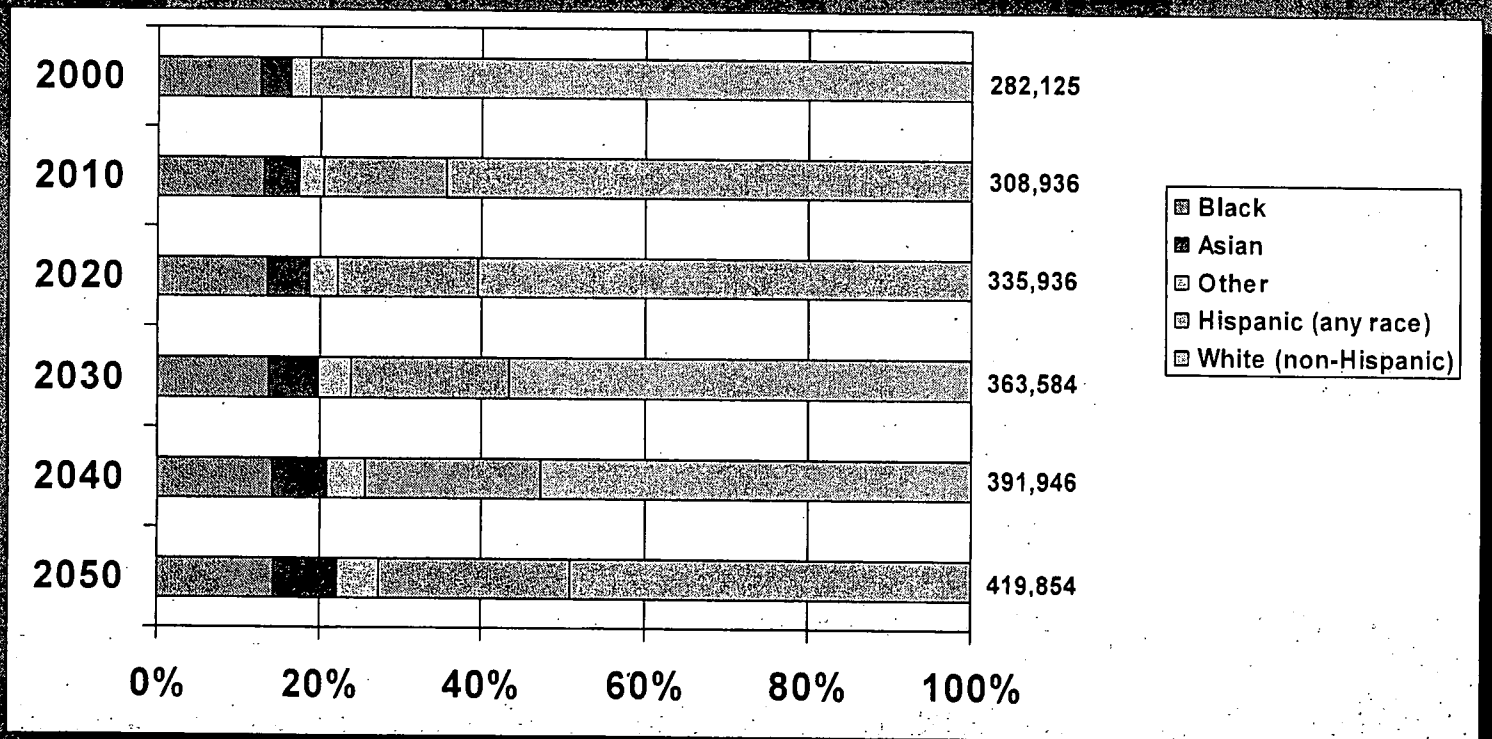
Population Projections, by Race and Hispanic Origin, 2000-2050, All Ages



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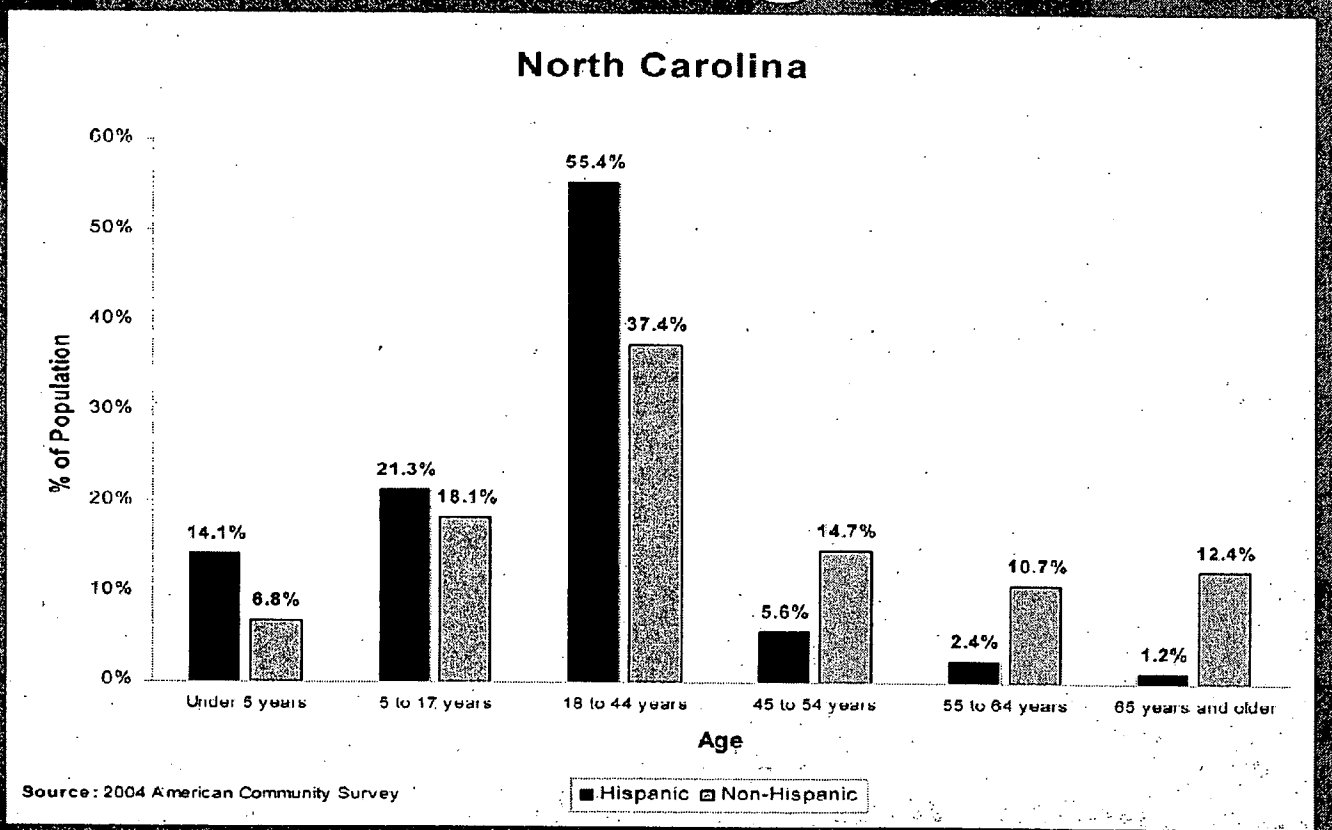
Population in North Carolina by Age and Hispanic Origin, 2004



Implications

- Embrace diversity as a competitive advantage
- Competition for talent will be fierce – and global
- People and firms are consumers of place
- Consider the implications of second wave of globalization in your deliberations

The History of State and Local Taxes in North Carolina - Changes in Sources and Burdens

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November 28, 2006

The History of State and Local Taxes in North Carolina - Changes in Sources and Burdens

State and local government in North Carolina provide funds for many critical services including schools and universities, highways and public transportation, healthcare for children and the elderly, public safety, water and sewer services and environmental protection. While the costs of these services continue to grow, the state tax system has largely been unable to keep up with the escalating costs resulting in projected budget shortfalls, significant budget cuts for many programs, and a variety of stop-gap, and temporary tax increases. In order to better understand this inability of the tax system to provide the revenue needed to meet North Carolina's growing budget needs, it is helpful to look back over the last several decades at changes in sources of state and local tax revenue and changes in North Carolina's tax burden.

Background

The North Carolina state and local tax system as we know it today was largely set in place in the 1920s and early 1930s. In 1921, most state revenue came from the property tax. However, in that year, the General Assembly enacted a state personal income tax, corporate income tax and gas tax, and the property tax became strictly a local-level tax.

As the state assumed or increased responsibility for schools, highways and prisons in the early years of the Great Depression, other sources of revenue were needed. Consequently, in 1933, the state became the second in the nation to enact a retail sales tax.

This basic structure of North Carolina's state tax system remained fairly constant over the next 70 years. Then and now, the primary sources of tax revenue for the state are the individual income tax, corporate income tax and the sales tax. The primary sources of tax revenue for local governments are property taxes and sales taxes.

Individual income tax

North Carolina's individual income tax has been in place since 1921. Before 1989, the state had its own individual income tax system independent of the federal tax. In 1989 the state piggybacked on the federal income tax in that the starting point for calculating North Carolina taxable income was (and is) federal taxable income. From that base, various adjustments are made in calculating North Carolina taxable income. The individual income tax rate is progressive, that is rates increase as income levels increase. In the early years, tax rates ranged from 3% to 7%. In 1989, the rate structure was streamlined to include just two rates - 6% and 7%. In 1991, as the state faced budget difficulties, a third rate of 7.75% was added and in 2001, a fourth bracket of 8.25% was added as a temporary increase. The 8.25% top rate will decline to 8% on January 1, 2007.

Corporate income tax

In contrast to the individual income tax, the corporate income tax is assessed at a flat rate of 6.9% on the income of corporations doing business in North Carolina. The owners of businesses that operate as sole proprietorships (typical of many small businesses) pay tax on business

income at individual income tax rates, not corporate rates. Likewise, the owners of businesses that operate as partnerships or limited liability companies typically pay tax on business income at individual tax rates.

Sales tax

North Carolina's sales tax is imposed on the retail sale of most tangible personal property in the state. Some items like prescription drugs and groceries (except prepared foods, candy, soft drinks and the like) are exempt from the tax. Most services are not subject to the tax. In 1933, North Carolina had a 3% state-level sales tax. In 1971, the General Assembly allowed local governments to levy a 1% local sales tax. The local tax was increased by .5% in 1983, .5% in 1986, and .5% in 2002. The state-level tax was increased to 4% in 1991 and a temporary increase of .5% was added in 2001. Consequently, today we have a state-level sales tax of 4.5% and a local-level sales tax of 2.5% (3% in Mecklenburg County). The 4.5% state rate will decline to 4.25% on January 1, 2007.

While sales taxes are "flat" in that one rate applies to all taxpayers, the taxes are sometimes criticized as being regressive in nature. Low income taxpayers may consume a higher percentage of their income than high income taxpayers resulting in a higher average tax rate. For example, a taxpayer earning $30,000 per year and spending $25,000 on items subject to a 7% sales tax pays $1,750 in sales tax for an average rate of 5.8% of total income ($1,750 / $30,000). A second taxpayer earning $100,000 per year and spending $70,000 on purchases of products subject to the sales tax pays total sales tax of $4,900. His average tax rate is only 4.9% of total income.

Property tax

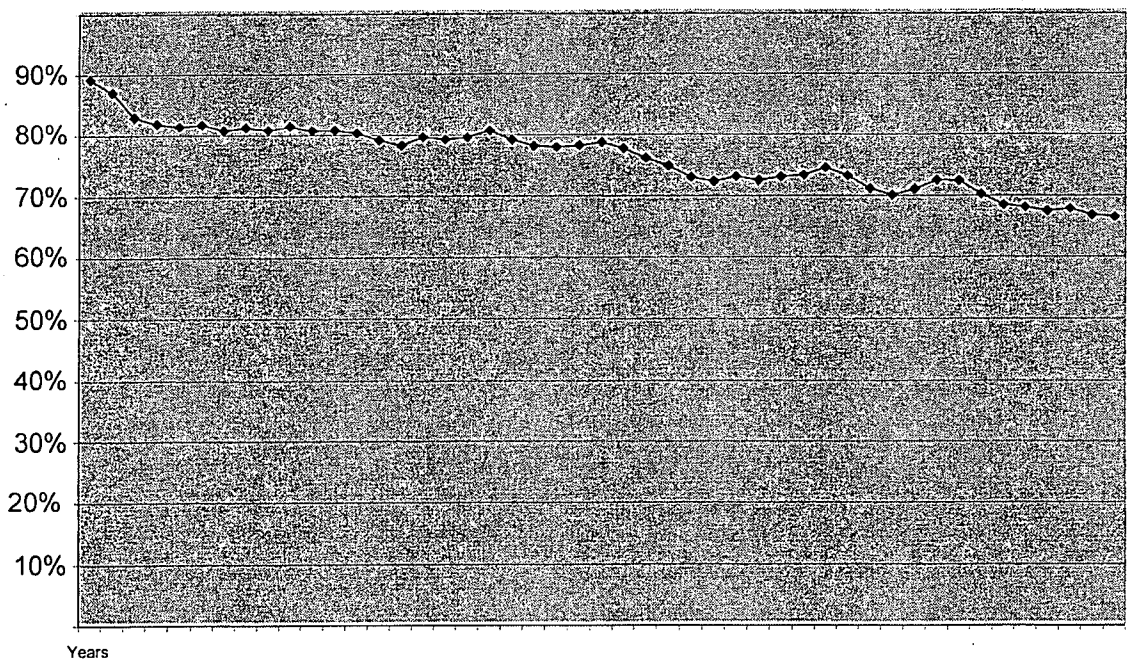
Since 1921, the property tax has been levied and administered by local jurisdictions rather than the state. The tax is imposed on the value of real property (land, buildings and other improvements to the land) and personal property used in a business. Tax rates vary by jurisdiction and can vary widely from one city or county to another. Until 1972, the property tax accounted for over 90% of the total local-level taxes collected in North Carolina. Although its importance at the local government level has declined, the property tax remains the primary source of tax revenue for local governments in North Carolina. In 2002, the property tax accounted for 77% of total local-level tax revenue.

An advantage of the property tax is that it is efficient and generally stable. It is easy to collect and less costly to collect than income or sales taxes. Although economic downturns inevitably are accompanied by declines in property values which cause the tax base to shrink, these downturns are often less volatile than those affecting the income tax or sales tax. In addition, most taxpayers generally consider property taxes to be fair although they can be problematic when increasing real estate prices are not accompanied by increases in wages and other sources of income used to pay the property tax. For example, retirees on fixed incomes may live in homes in which increases in value and property taxes far exceed any increase in income available to pay the tax.

Changes in Sources of State and Local Tax Revenue in North Carolina

In 1942, almost 90% of the state's general revenue from its own sources (not counting intergovernmental revenue) came from taxes (see Figure 1). The other 10% came from a variety of fees and charges and miscellaneous revenue. Sixty years later, taxes account for only about 66% of the state's own-source general revenue. Of course, the flipside is that fees, charges and miscellaneous revenue have increased to about 34% of general revenue. Fees and charges include a hodgepodge of items such as payments of tuition and fees by students enrolled in North Carolina public colleges and universities, payments made by patients and insurance programs to public hospitals, fees from toll highways, parking facilities, etc. Miscellaneous revenue includes interest earnings, revenue from the sale of property, special assessments, etc.

Figure 1 - NC Taxes as a percent of General Revenue from own sources



Years (1942 – 2002)

While the relative importance of taxes has declined over the last 60 years as the state and local governments have collected more and more revenue in the form of charges and fees, it is informative to look at increases and decreases in specific types of taxes during that time frame. Due to data limitations, detailed information on the amount of revenue from different taxes is only available since 1957. As shown in Table 1, in that year, 41.4% of total state and local government tax revenue in North Carolina came from sales taxes (both the general sales tax and selective taxes on such items as alcoholic beverages, cigarettes and gasoline). The second largest source of tax was the property tax (26.8%) followed by various license taxes (11%), the individual income tax (10.5%), and the corporate income tax (9.1%).

By 2002, the components of total tax revenue had dramatically changed. While the sales tax was still the largest component at 34.8%, the individual income tax accounted for over 32% of total tax revenue while the property tax declined in importance to 24% of total tax revenue and the

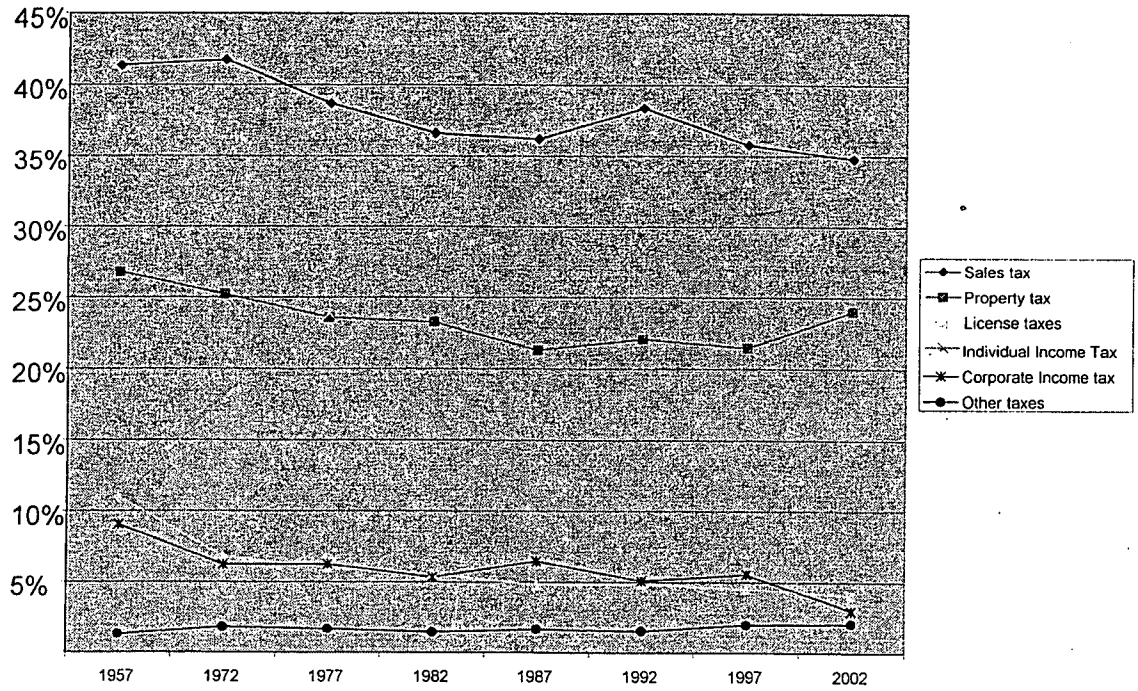
corporate income tax to only 3%. During this 45 year time span, property taxes, sales taxes, license taxes and corporate income taxes declined in importance. In 1957, these four taxes accounted for 88.3% of total tax revenue. In 2002, these taxes accounted for 65.8% of total tax revenue at the state and local level. During the same time, individual income taxes increased from a modest 10.5% of total taxes to over 32% of total taxes.

Table 1: Percent of Total NC State and Local Tax Revenue from Various Sources

	1957	2002
Sales Taxes	41.4%	34.8%
Property Taxes	26.8%	24.0%
License Taxes	11.0%	4.0%
Individual Income Taxes	10.5%	32.2%
Corporate Income Taxes	9.1%	3.0%
Other Taxes	1.2%	2.0%

As the trend lines in Figure 2 show, the percent of total taxes from the individual income tax increased rapidly between 1957 and 1987, moderated slightly between 1987 and 1992 and increased again over the ten year period from 1992 to 2002.

Figure 2 - Percent of NC Tax Revenue from Various Sources



North Carolina's Changing Tax Burden

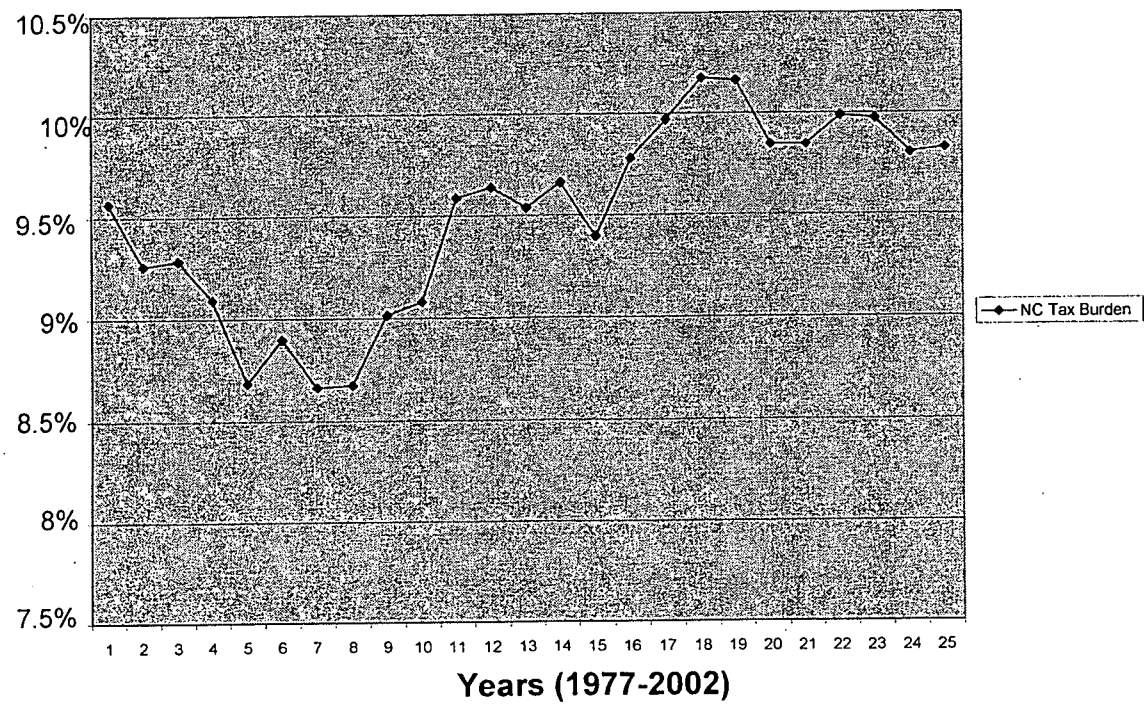
While it is clear that individual income taxes are more important to the state's tax coffers today than in the past, additional analysis is necessary in order to understand how taxpayer's state tax burdens have changed over time. A state's tax burden is measured by calculating taxes paid as a percent of income earned by the state's residents. Both state and local taxes are typically

included in the measure to ensure comparability of burdens across states. For example, some states provide services at the state-level that are provided by counties and other local government units in other states. As a result, the levels of the various taxes assessed at the state and local level frequently vary. While the state-level sales tax in North Carolina and Virginia are close to the same (4% in Virginia compared to 4.5% in North Carolina), North Carolina's local-level sales taxes vary from 2.5% to 3% while Virginia's highest local sales tax is 1%. In a ranking that includes only state-level sales taxes, North Carolina taxpayers appear less taxed in comparison to Virginia taxpayers (4.5% in North Carolina compared to 4% in Virginia) than they actually are (7% in North Carolina compared to 5% in Virginia).

In the following calculations of tax burden, taxes include individual income taxes, corporate income taxes, property taxes, general sales taxes, selective sales taxes such as those on gasoline, tobacco products, and alcoholic beverages, license taxes and other taxes such as estate and gift taxes. Personal income (as defined by the U.S. Census Bureau) is used as a measure of income earned by the state's residents. Personal income is the income that is received by all persons in the state from all sources. It includes not only wage and salary income but also rental income, dividend income, interest income, and income earned by small business proprietors.

As shown in Figure 3, the tax burden over the last 25 years has ranged from about 8.7% to 10.1% with a generally increasing trend since about 1984.

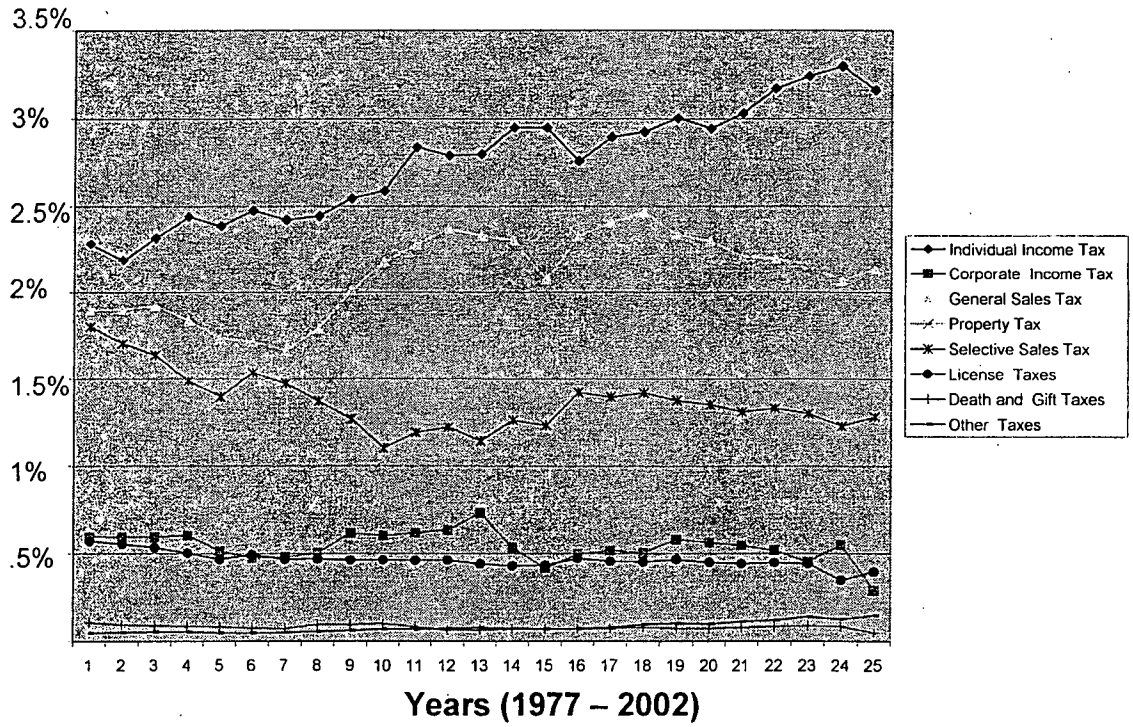
Figure 3 - NC State and Local Taxes as a Percent of Personal Income



More interesting is how different types of taxes contributed to the tax burden during those years. As shown in Figure 4, the individual income tax has contributed a steadily increasing amount to the tax burden over the last 25 years. In 1977, the individual income tax burden was 2.3% of personal income. In the first half of the 1980s, the individual tax burden was relatively stable

before starting an increasing trend in 1984. The burden increased steadily between 1984 and 1987 before moderating slightly in 1988 and 1989. After a fairly significant drop between 1991 and 1992, the individual tax burden increased again between 1992 and 1993 – perhaps as a response to the 1991 tax increase - and has increased almost every year since, spiking at 3.3% in 2000 before declining modestly in 2002 to 3.2% of personal income.

Figure 4 - NC Tax Burden by Type of Tax



With the exception of 2002, the property tax has remained in a fairly narrow range from 1.9% of personal income to 2.2% of personal income. In 2002, the property tax burden jumped to 2.4%.

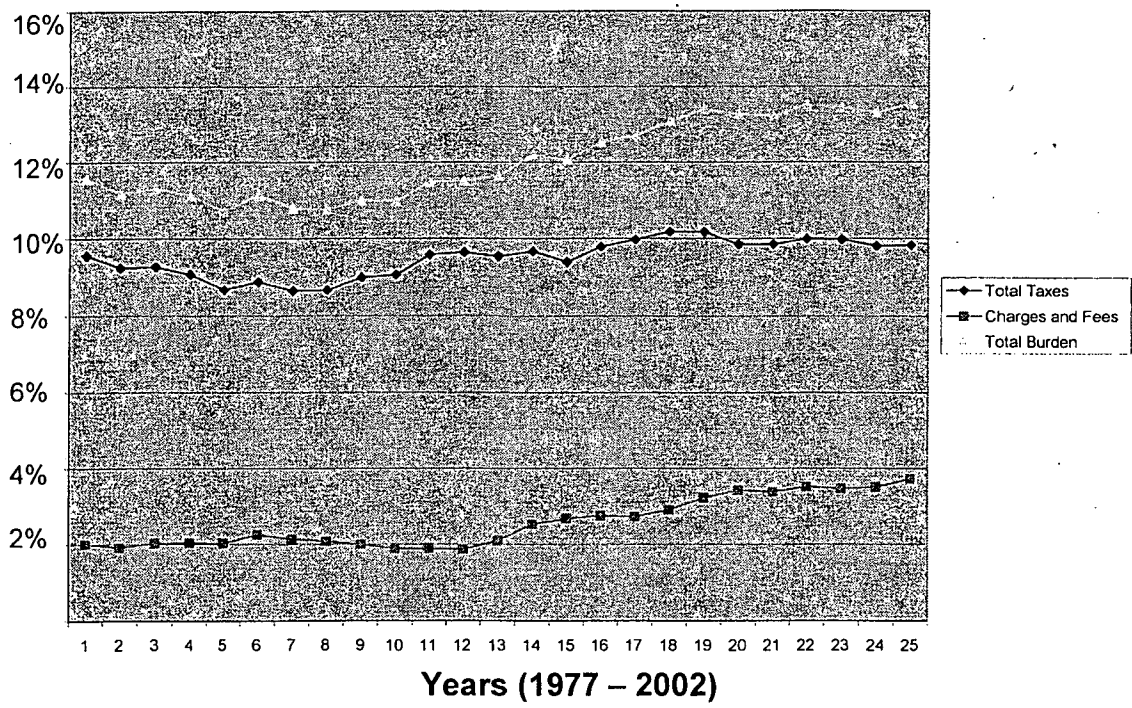
The general sales tax burden has changed over the last 25 years in response to increases in the state and local sales tax rate as well as in response to changing economic conditions. The trend line shows general increases in the sales tax burden from about 1983 to 1990 followed by a large drop in 1991. The state increased the state-level tax from 3% to 4% in that year and the general sales tax burden increased until about 1994. However, the sales tax burden has generally declined since 1994. Possible explanations for this decrease include the growth of electronic commerce and sales on the Internet and the growth of the service economy. Companies that sell products via the Internet are responsible for collecting and remitting sales tax to the state only if the firm has a physical presence in the state. Often times, this is not the case. While buyers have an obligation to pay use tax on these purchases, collection of the use tax from individual buyers is difficult at best. As discussed earlier, most services are not subject to the sales tax.

The corporate income tax has been a relatively unimportant source of income tax revenue for the state for the last 45years, never amounting to over 10% of the total tax revenue collected by the state over that period of time. After trending upward in the mid 1980s to a peak of .73% in 1989, the corporate income tax burden has fallen to a historic low of .3% in 2002. License taxes, death

and gift taxes and other taxes have remained relatively stable since 1977 and are responsible for only a small portion of the overall state and local tax burden.
Although fees and charges are not considered taxes, they nevertheless contribute to the total burden borne by North Carolina taxpayers. As discussed earlier, fees and charges include payments of tuition and fees by students enrolled in North Carolina public colleges and universities, payments made by patients and insurance programs to public hospitals, fees from toll highways, parking facilities, etc. In addition to changes in the tax burden, it is important to see how the burden from these fees and charges has changed over time. Due to political pressures to reduce taxes (or at least not raise taxes), fees and charges are sometimes increased as a way to increase revenue when it is politically difficult to raise taxes.

In Figure 5, the overall burden is broken down into its components – the tax burden and the burden from fees and charges.

Figure 5 - Total Burden



As shown above, the total burden (consisting of taxes, fees and charges) and the tax burden decreased between 1977 and 1981 while the burden from fees and charges remained flat. However, the trend has been upward since 1981. Over the last two decades, the overall burden from fees, charges and taxes increased from 10.7% to 13.5%, with the burden from fees and charges increasing from 2.0% to 3.7% and the burden from taxes increasing from 8.7% to 9.8%. The increasing tax burden was primarily a result of increases in the burden from individual income taxes which increased from 2.4% in 1981 to 3.2% in 2002.

Conclusion

North Carolina's basic state and local tax structure has changed little since the 1930s. Today, the state and local governments rely (as they did in the 1930s) on the individual income tax, sales tax, property tax, corporate income tax and various license taxes to generate a large portion of the state's revenue. However, the relative importance of taxes has declined as the state and local governments in North Carolina have increasingly relied on fees and charges instead of taxes to finance government spending. In addition, the individual income tax has grown in importance as a source of revenue for the state. In 1957, sales taxes were the primary source of revenue, accounting for over 41% of total tax revenue while the individual income tax accounted for 10.5% of total state and local tax revenue. In 2002, the individual income tax accounted for over 32% of total tax revenue.

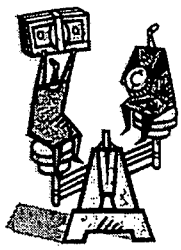
The state's increasing reliance on fees and charges and individual income taxes is also apparent when examining changes in the state's tax burden and overall burden. These changes are important to recognize as they may impact the distribution of the tax burden and the equity of the overall tax system in North Carolina. While the individual income tax is progressive, fees and charges are typically regressive resulting in a greater burden on low income taxpayers in the state. In addition, a state's tax burden can be an important factor in business location decisions. Increases in the overall burden and the tax burden may adversely impact the ability of the state to compete with other states for new businesses.

NORTH CAROLINA'S TAX BURDEN: MEASUREMENT AND ISSUES

Dr. Mike Walden
Reynolds Distinguished Professor
N.C. State Univ.

1

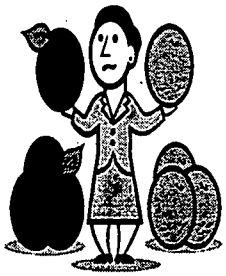
BETTER: PUBLIC SECTOR COSTS



Balancing costs (taxes) and benefits (public services)

2

ISSUE 1: STATE + LOCAL TAXES TOGETHER?



Yes, because states divide state and local functions differently -- if not, an "apples and oranges" comparison

3

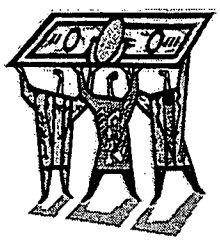
ISSUE 2: INCLUDE PUBLIC FEES?

Charges for direct benefits to an individual

Taxes: Used for "general" benefits

4

ISSUE 3: PEOPLE OR DOLLARS?



Taxes per capita

or

Taxes as a percent of income

5

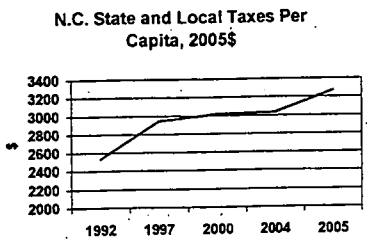
2005 RESULTS: TAXES PER CAPITA

$3268 per person

Ranked 30th highest in nation

Behind VA, GA, FL
Ahead of SC & TN

6



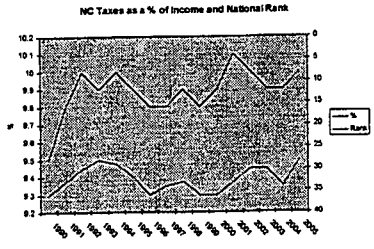
7

2005 TAXES AS A % OF INCOME

10%
Ranked 28th in nation

GA: 9.8%
SC: 9.7%
VA: 9.7%
FL: 9.2%
TN: 8.3%

8



9

N.C. FEES AND CHARGES - 2004

Per capita: $1038
Ranked 2nd in SE (SC)

% of income: 3.6%
Ranked 2nd in SE (SC)

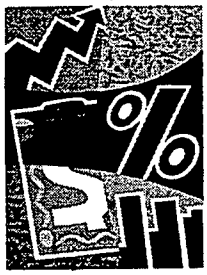
10

SPECIFIC TAXES – PER CAPITA

Tax	Rank in SE (2004)
Property	5
Sales	5
Indiv. Income	2
Corp. Income	1
Gas & Veh. Ls	3

11

SPECIFIC TAXES - % OF INCOME



Tax	Rank in SE (2004)
Property	5
Sales	5
Indiv. Income	1
Corp. Income	2
Fuel & Veh. Ls.	T 1,2,3

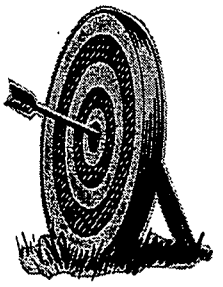
12

BUT – TAXES CAN'T BE VIEWED IN ISOLATION

Studies show public spending on education, roads, and public safety can promote economic growth and counter impact of taxes

13

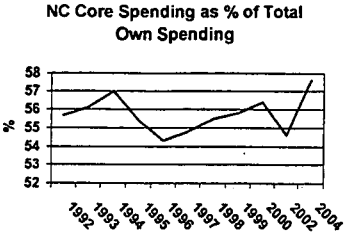
NC IS A LEADER IN "CORE" SPENDING



Public spending on education, roads, and public safety as a % of own revenues, '04

NC: 58%
Nat'l aver.: 53%
NC is 2nd in SE

14



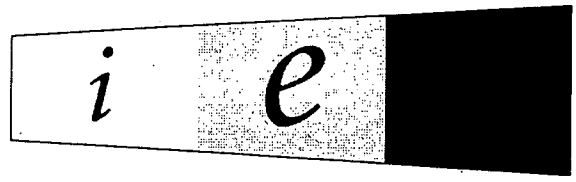
15

CONCLUSIONS

Rankings and comparisons of tax burden (public costs) are important

But consider in context of where public funds are spent

16



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Overview of State and Local Division of Responsibilities and Funding

Dr. Roland Stephen

November 28, 2006

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research ideas debate action leadership

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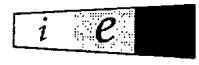

Institute for Emerging Issues

What Is the Institute for Emerging Issues?

- IEI is a think and do tank that turns ideas into action.
- We help new combinations of leaders adopt innovative public policies to prepare North Carolina for its future.
- Financing the Future is a program of work to modernize state and local finance.

www.emergingissues.org

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Presentation Outline

(1) Map of state, county and municipal spending
- Generally
- Urban and rural distinction
- By spending category

(2) Understanding of where there is a mismatch between responsibilities and funding;
- General examples
- No reference to funding formulas

(3) Map of state, county and municipal revenues
- Heavy dependence on income and property tax

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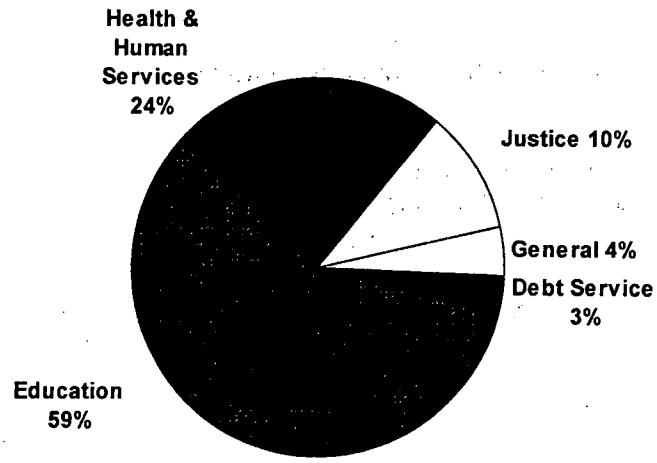
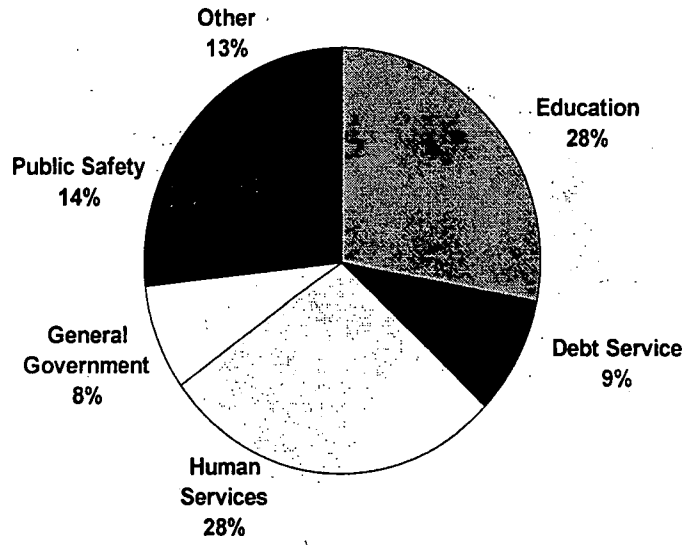
2005–06 State Government General Fund Expenditures

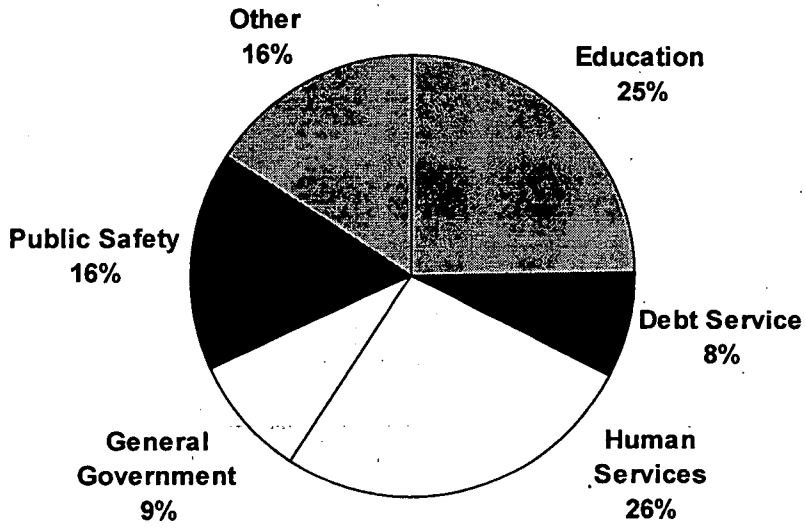
Total of $16 Billion



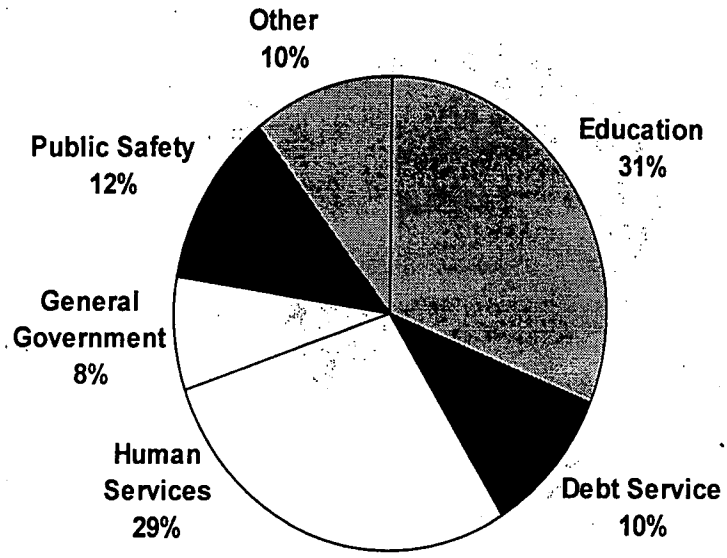
2004-05 Statewide Averages of County Expenditures
Total of $10.8 Billion



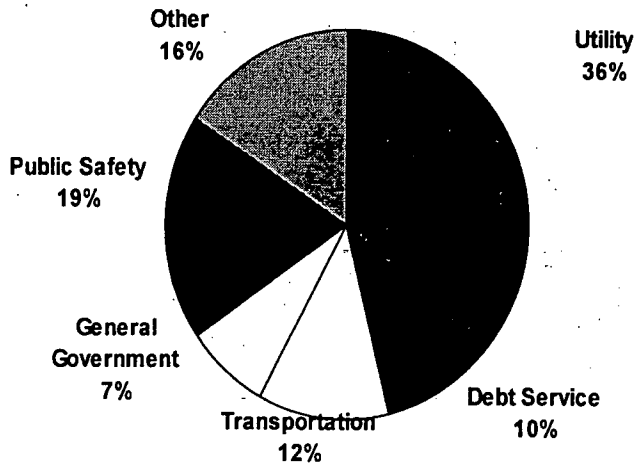
2004-05 Statewide Averages of Rural County Expenditures



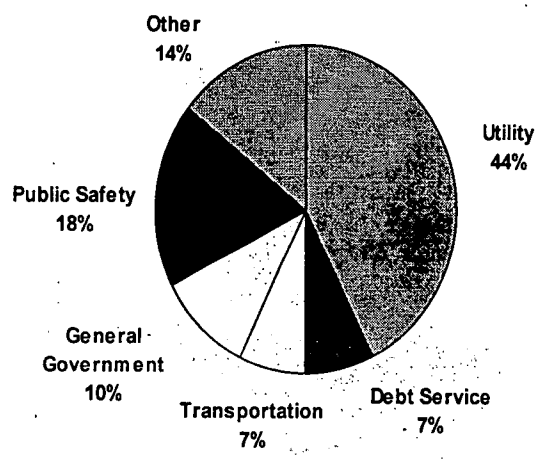
2004-05 Statewide Averages of Urban County Expenditures



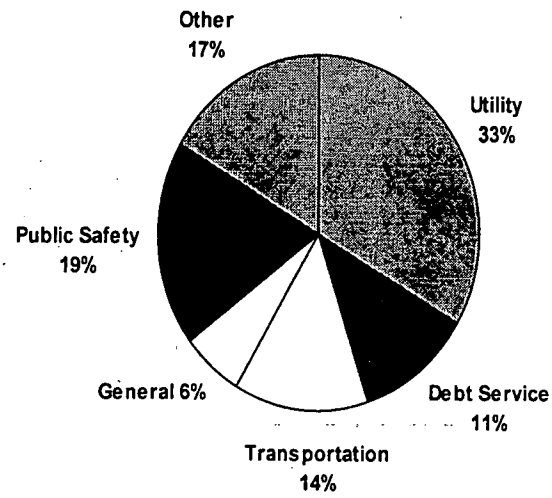
2005–06 Statewide Municipal Expenditures



City Expenditures With Populations Under 25,000

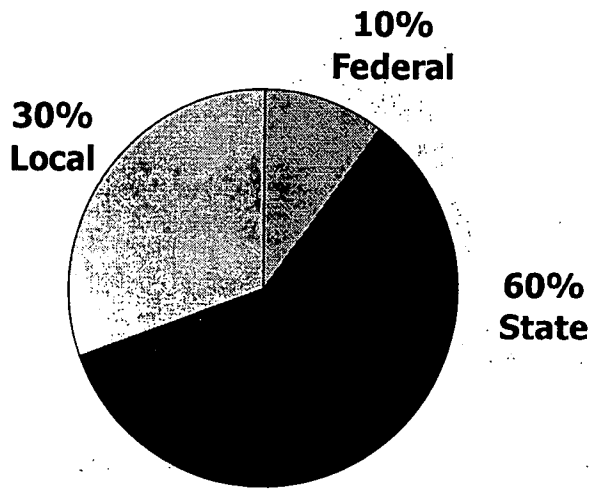


City Expenditures With Populations Over 25,000

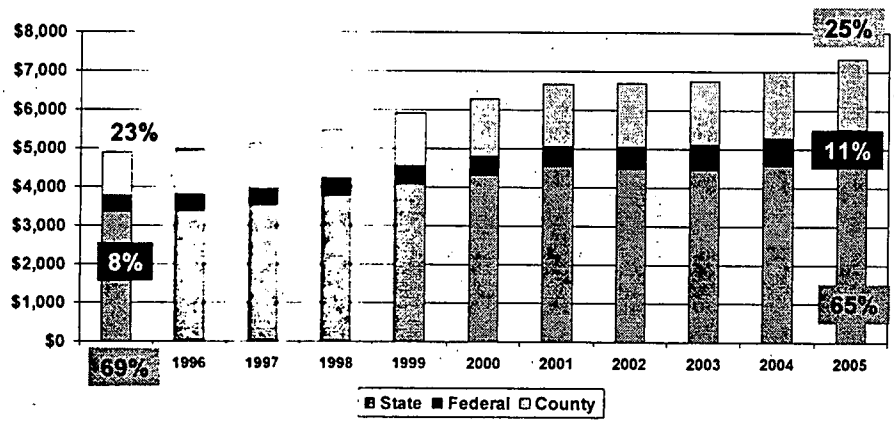


Who Pays for Public Schools?

$10.6 Billion Total Budget



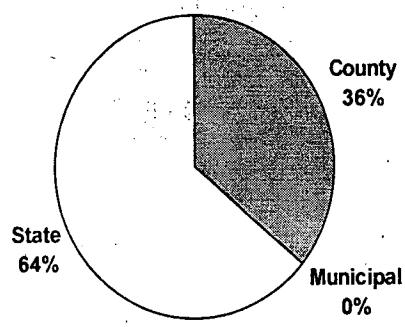
Per Pupil Funding
Current Expense



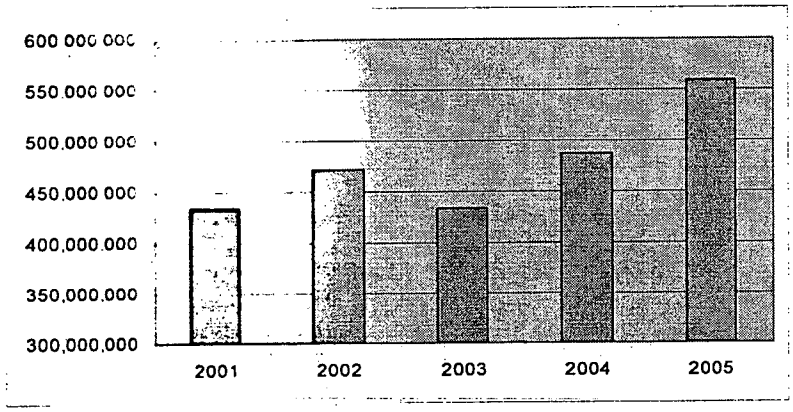
Who Pays for Health and Human Services?

Total budget $7.9 billion

2004 - 2005 Share of Health and Human Services Expenditures

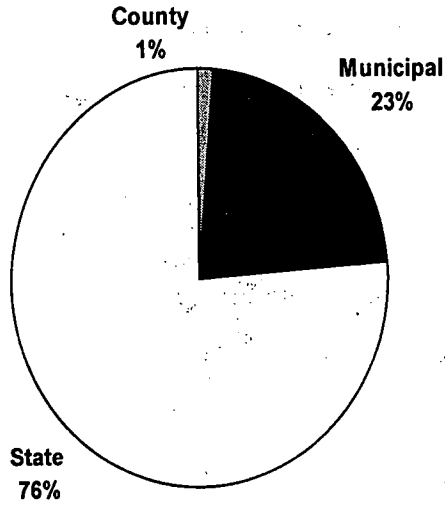


County Medicaid Cost Increases Since 2001



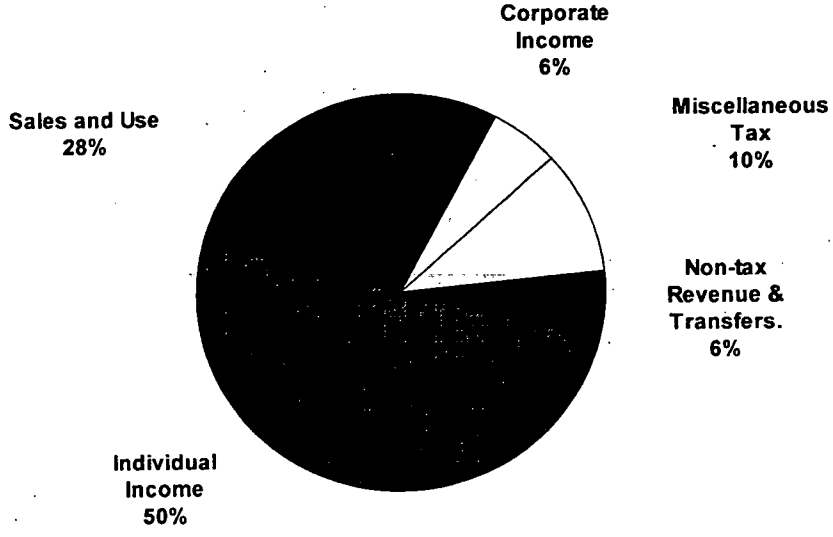
Who Pays for Transportation?

Total Budget $4.4 billion



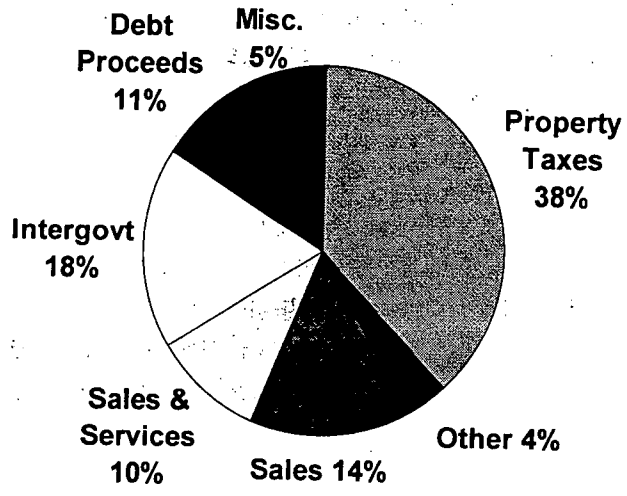
2005-2006 State Government General Fund Revenues

Total budget $16.89 billion



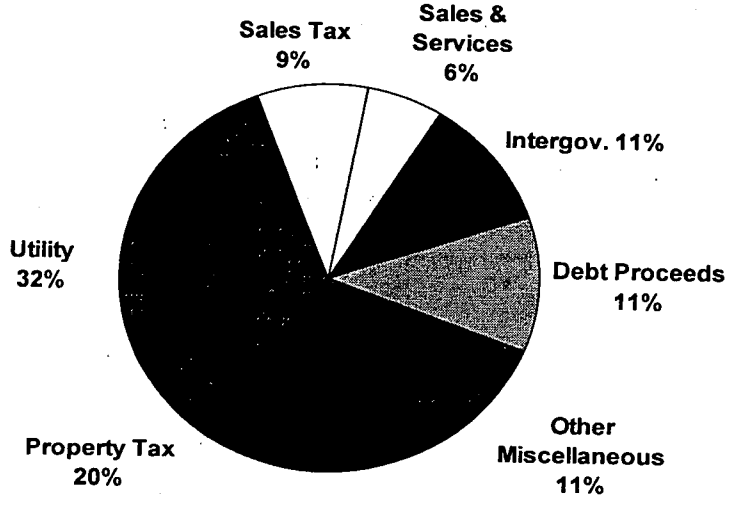
2004-05 County Revenues

Total budget $11.3 billion



2005 – 2006 Municipal Revenues

Total budget $8.5 billion



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Conclusion

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- There are things that the state says it will pay for, but does not (ie, adequate roads & funding to operate schools)
- There are things that county governments do pay for, but shouldn't (ie Medicaid)
- There are things that local government could pay for (ie, roads in urban areas) or are unable to pay for (ie, water and sewer in rural areas)
- There are things that local government should pay for but sometimes won't (ie, capital school construction)

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Conclusion

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- Responsibilities and funding should be matched by an appropriate source of revenue.
- Only a comprehensive solution to fiscal modernization can match revenues with responsibilities and address all major challenges.

The Long Term Gap in North Carolina's Revenues and Expenditures

Prepared by Institute for Emerging Issues

Introduction

The fiscal discipline imposed by the recent recession, combined with a series of tax increases has put North Carolina in a position where the current short-term economic outlook is good. In fact, North Carolina is enjoying a $2.4 billion surplus of revenues over expenditures. Unfortunately, the revenue increase is largely based on volatile revenue sources, and the revenue availability is primarily nonrecurring in nature.

Over the long term, the revenue outlook appears much more bleak. The reasons for this are simple: state revenues will decline in the future when the economy experiences a downturn; and North Carolina may overcompensate for prior tax increases by cutting taxes to levels below those needed to maintain services; and future expenditures for basic services will be unable to keep up with the revenue base upon which they depend.

North Carolina has spending obligations that are growing more rapidly than the economy. Education and medical services for the poor and disabled are two of the most critical. Compounding the issue, the fraction of residents who complete secondary and higher education is growing, as is the fraction of residents who are eligible for Medicaid. At the same time, North Carolina depends on revenue sources that grow more slowly than the economy. In particular, the state leans heavily on a retail sales tax, whose base continues to shrink.

The following sections outline the largest expenditure needs, followed by the largest revenue sources upon which the state depends. This overview reveals that revenue sources in the future will be unable to keep up with both growth in the economy and basic expenditures. This problem is what is termed a "structural deficit." Most states face this problem. Some are in much more difficult circumstances than North Carolina. Nearly all must modernize elements of their revenue systems if structural deficits are to be rectified.

North Carolina's Largest Critical Expenditures

Part of North Carolina's structural deficit is due to the fact that revenues are unable to finance continual expenditure growth year after year. Continual spending here refers to the existing services and programs rather than the addition of new ones.

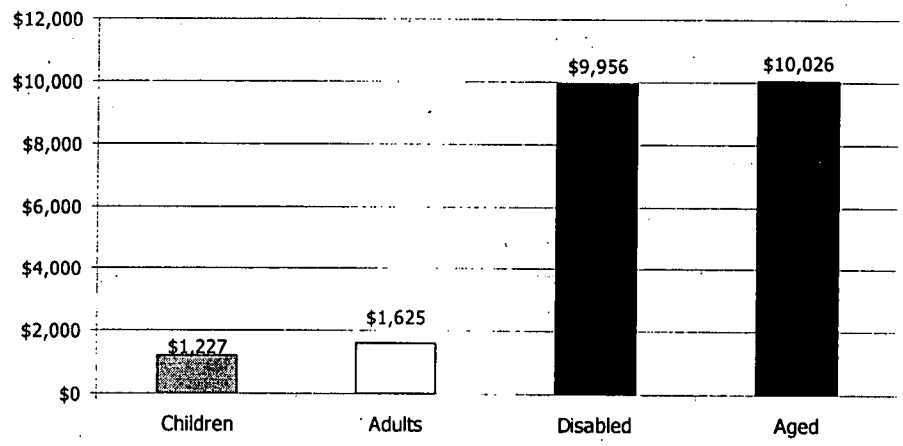
North Carolina's spending on Medicaid and education accounts for 77 percent of the state's current expenditures. The costs of these important services have increased dramatically in recent years and will continue to do so in the coming years. There are many ways to limit these increasing costs, but it would be optimistic to imagine that any proposed solutions on the spending side could do more than keep costs in line with growth in the overall economy. Furthermore, Medicaid reform will require Federal action.

Medicaid Spending

Nationally, Medicaid covers over 45 million clients, including low-income women and their children, the disabled and the elderly. Medicaid covers about one-third of all births in the country and provides health insurance for one in every five children. It accounts for almost one-half of total spending on long-term care and significant portions of state spending on programs for the mentally ill and developmentally disabled.

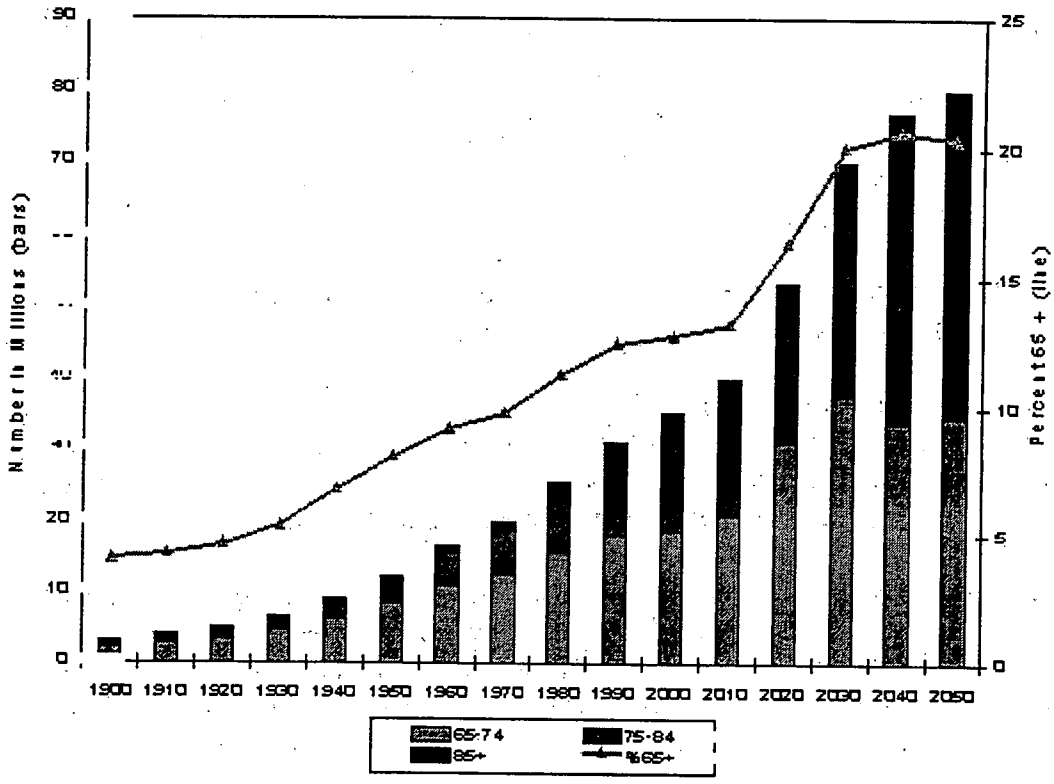
Medicaid is a major item in North Carolina's state budget, where it accounts for 17 percent of state spending. By 2030, Medicaid is likely to grow to 53 percent of overall state spending based on moderate national growth assumptions by the Congressional Budget Office (CBO) applied to current state spending.

National Annual Medicaid Spending Per Recipient By Group



Increased state Medicaid costs reflect a national trend. Over the last fifteen years, nationwide Medicaid spending has increased from approximately $1.5 billion in 1990 to $7.5 billion in 2005. The Congressional Budget Office (CBO) estimates that Medicaid costs may rise 9 percent per year over the next ten years. Currently, 80 percent of Medicaid expenditures are for the elderly and disabled. As the baby boom generation ages and needs increasing levels of medical care, costs are likely to rise exponentially.

Population of 65+ Citizens Nationwide



North Carolina is greatly affected by these trends. The state is aging considerably, due in part to the influx of older Americans moving to North Carolina for retirement. Among all age groups in the state, the greatest population increase is projected to occur among individuals 65 years and older. As a result, the state will be increasingly invested in the healthcare needs of the elderly. Not only is the state growing older, but also it is becoming more diverse. Among all racial groups, the Hispanic population is growing the fastest. Data suggests that this population group uses Medicaid.

Education

Education spending in North Carolina accounts for roughly 60 percent of overall state spending. Increased education spending in the years to come depends on several factors including population growth, rising per pupil costs and a landmark court case known as *Leandro.*

North Carolina is set to grow at an astounding rate. By 2030, the state's population is projected to increase by over 50 percent from the 2000 Census figures, lifting the state to a rank of 7th in total population. Overall, this growth will be driven by an influx of people from outside of the state. Based on U.S. Census data, from 2000 to 2004, North Carolina netted an increase of 39,137 people per year, the fifth highest in the United States over that same period. Wake County had the 25th highest rate of net immigration for all counties among the United States and Currituck County ranked 18th among the nation's counties in its rate of annual growth from domestic immigration. As a result of this growth, North Carolina will be forced to focus its

attention in several areas, including capacity of the state's school system to handle increasing enrollment.

Beyond the influx of students from a growing population, the number of students continuing their education after high school is expected to rise. The U.S. Census Bureau estimates that over the next 15 years the percentage of high school graduates going on to college will rise from 32 percent to 41 percent. Coupled with the passing of the echo boom generation -- the large pool of children born between 1982 and 1995 -- through college, this promises to dramatically increase college enrollment in the coming years.

In addition to the numbers enrolled in school, per pupil costs have been rising steadily over the past two decades, and this trend is projected to continue.

Finally, increased education costs in the years to come will be based in part on a landmark court case entitled *Leandro*.[1] Low-income school districts sued the state charging that children in their districts had been denied an adequate education because the state's system of funding education failed to provide adequate resources for low-income school districts.

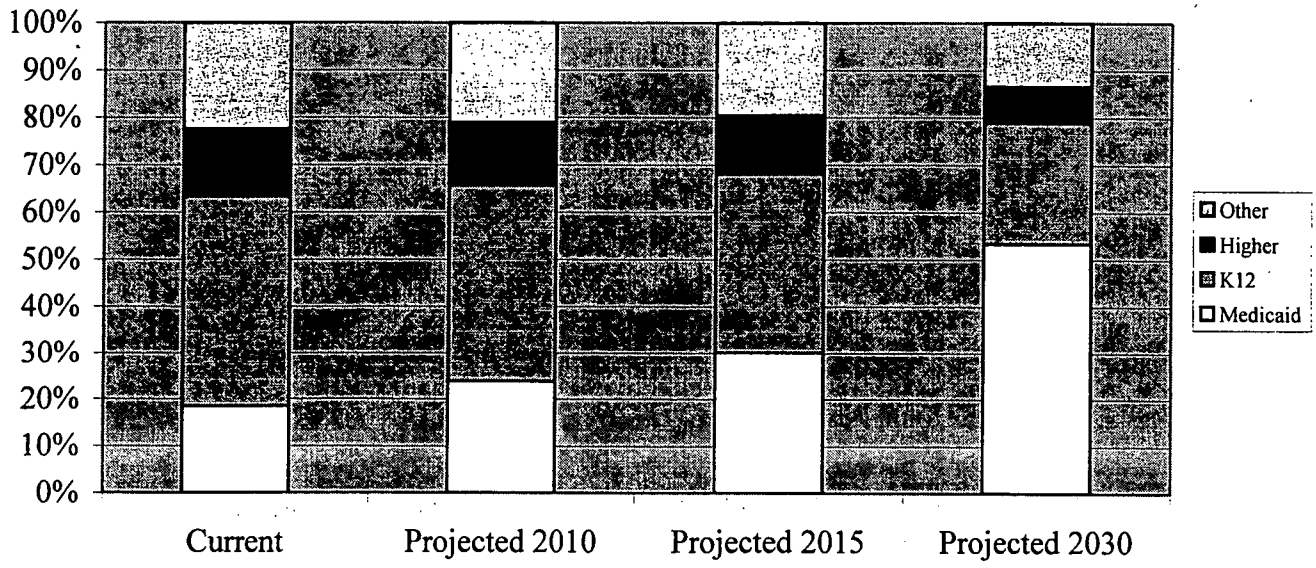
The North Carolina Supreme Court ruled that the ultimate responsibility of educating the population of North Carolina falls on the state and not on localities. As a result, the courts have mandated that the state must supplement local districts that cannot afford to provide students with a basic education. While the exact liability the state faces is still in question, increases in costs for primary and secondary education will be born, at least in part, by the state in the years to come.

The graph on the next page illustrates the role that education and Medicaid will continue to play in the years to come. Even though education will comprise a significant portion of all state expenditures, Medicaid will continue to grow the fastest.

Problems will exist in other spending categories. North Carolina's population is expected to grow rapidly in the next 25 years, leading to a dramatic increase in spending on infrastructure. Yet neither Federal nor state sources of revenue dedicated to road construction are able to meet even today's needs.

[1] *Leandro v. State*, 488 S.E. 2d 249 (1997).

North Carolina State Government Spending in Major Expenditure Categories



North Carolina's Largest Revenue Sources

North Carolina depends most heavily on two revenue sources – the retail sales tax and the personal income tax. At present, these two revenue sources comprise 84 percent of the total state revenue. However, certain characteristics of these two revenue sources contribute to the structural deficit referenced earlier.

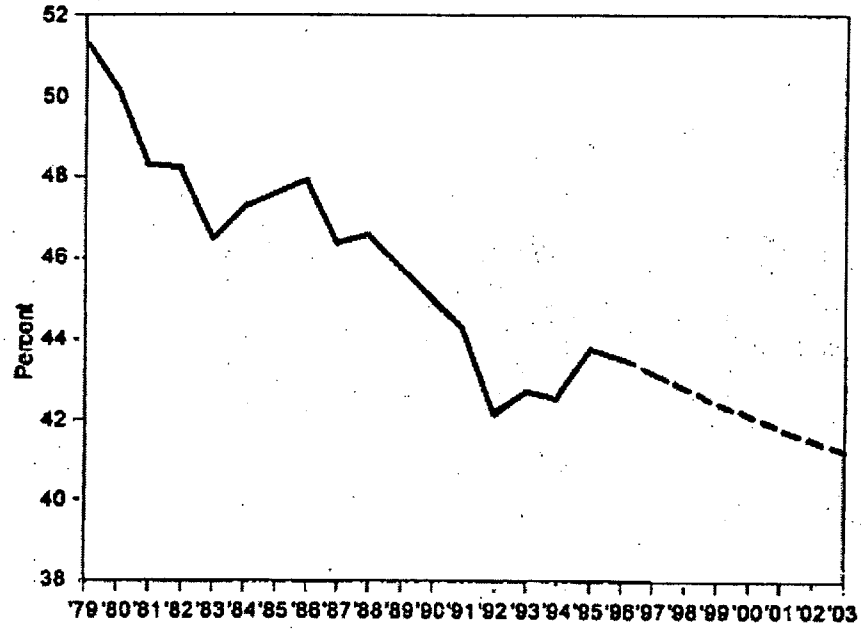
Retail Sales Tax

The retail sales tax is levied on all tangible goods and a few basic services. In other words, the tax only applies to a part of all the sales in the economy. This retail base -- as a proportion of the whole -- has and will continue to decline over time, contributing to structural problems for the state's revenue system. This decline is due to three factors:

- Increased movement toward a service economy
- Increased interstate sales
- Decreased personal spending as a percentage of income among wealthy residents

First, the North Carolina economy is shifting from goods to services, yet services remain largely untaxed. As a result, an increasingly large percentage of the economy is not taxed. Second, the growth of the Internet has led to a proliferation of on-line sales. On-line sales are not subject to sales taxes. Finally, the state's wealthiest residents are spending less on goods as a percentage of personal income. The graph below on the next page shows this trend over time.

Sales Tax Base as a Percentage of Personal Incomes



The combination of all these factors will lead the retail sales tax revenue to decline from approximately 30 percent of all state revenue collected to a significantly smaller percentage over time.

Personal Income Tax

The personal income tax in North Carolina is the largest source for state revenue, accounting for roughly half of all state revenue. North Carolina has a progressive income tax structure with the bottom rate set at 6 percent and the top rate set at 8.25 percent for income in excess of $120,000 per year. During the 2006 General Assembly Short Session, the Legislature reduced the top personal income tax rate from 8.25% to 8% to take effect on January 1, 2007, somewhat reversing a temporary tax increase that was put into effect in 2001.

Bracket creep, a term used to describe how inflation pushes individuals into higher tax brackets, has largely made up for the decline in sales tax revenue. In the short run, bracket creep helps increase state revenues, but this development is unsustainable in the long run unless there are constant increases in the top rate of the income tax. North Carolina's state income tax structure will eventually become flatter and flatter as many taxpayers become crowded into the top rates. If the state moves to reduce the top rate, this will further reduce the growth of income tax collections relative to economic growth.

This income tax flattening creates the following concerns:

- Decreased progressivity
- Reduction in revenue growth

Under a progressive income tax schedule, wealthier residents pay a larger percentage of their income in tax compared to others. Under a flatter income tax structure, individual taxpayers pay a similar percentage of their income in tax.

Under a progressive income tax, revenues grow quickly but tend to be volatile based on the state of the economy. Without a progressive income tax, overall revenue growth becomes steadier but grows at a slower rate than the economy.

In combination, North Carolina depends heavily on two sources of revenues with fundamental problems. The sales tax does not grow as the economy grows. The income tax as currently structured is volatile, and cannot grow as quickly in the future as it has in the past.

The Gap

In conclusion, the current budget surplus is likely to be eroded in just a year or two by increasing expenditures and volatile revenue sources. In the long run the state budget faces a structural deficit that demands attention. No single solution exists that will solve this problem.

Comparative Analysis of North Carolina Service Responsibility Sharing Between State and Local Governments

Summary of Findings

By
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Department of Government & History
Fayetteville State University
Fayetteville, NC 28301

1

Study Objectives

- Determine if the way North Carolina (NC) shares responsibility for Education, Public Welfare, Health, and Transportation services is different from comparable States.

2

Study Questions

- What is the percent distribution of responsibility sharing between NC State government and NC local governments?
- What is the average percent distribution of responsibility sharing between comparable State governments and their local governments?

3

Definition of Comparable States

- States with the same or close to the same Expenditure Need per Capital as NC, and/or
- States with the same or close to the same (i.e. + or -3% difference from NC's) Expenditure Need Index as NC

Comparable States

- Arizona
- Kentucky
- North Dakota
- Utah

California
Michigan
Oklahoma
West Virginia

Illinois
New York
Tennessee

5

Education Services

- Include: Higher education, elementary and secondary education, and public libraries.

(*Source: Census of Governments, 2003-04)*

Table 1: Education Service
(dollars expressed in 000)

State	Expenditure Need Per Capita	Expenditure Index	Total Amount	State Amount	State Percent	Local Amount	Local Percent
North Carolina	6113	102	$17,433,865	$6,058,408	35%	$11,375,457	65%
Arizona	6128	102	$10,213,306	$2,695,112	26%	$7,518,194	74%
California	6211	103	$85,534,897	$18,398,977	22%	$67,135,920	78%
Illinois	6126	102	$29,260,593	$7,089,256	24%	$22,171,337	76%
Kentucky	6141	102	$7,842,401	$3,196,209	41%	$4,646,192	59%
Michigan	6255	104	$27,335,128	$7,664,053	28%	$19,671,075	72%
New York	6052	101	$52,456,231	$8,556,759	16%	$43,866,472	84%
North Dakota	6248	104	$1,535,960	$636,157	41%	$899,803	59%
Oklahoma	6059	101	$6,993,244	$2,611,289	37%	$4,381,955	63%
Tennessee	6271	104	$9,882,178	$3,085,757	31%	$6,796,421	69%
Utah	6181	103	$5,417,748	$2,445,129	45%	$3,063,619	55%
West Virginia	6227	104	$3,773,883	$1,332,923	35%	$2,440,960	65%
Comparable States Average			**$21,840,506**	**$5,246,511**	**32%**	**$16,599,268**	**69%**

Education Services

- The structure of education service responsibility sharing between NC's state government and its local government is similar to that of comparable states.
- NC's 35% is close to the average of 32%
- Four states assume more responsibility while six states assume less responsibility

8

Public Welfare Services

- Include: cash assistance payments, vendor payments, and public employment for all public welfare activities and expenditure for welfare not classified elsewhere.

(*Source: Census of Governments, 2003-04*)

Table 2: Public Welfare

(dollars expressed in 000)

State	Expenditure Need Per Capita	Expenditure Index	Total Amount	State Amount	State Percent	Local Amount	Local Percent
North Carolina	6113	102	$8,570,016	$7,328,124	86%	$1,241,892	14%
Arizona	6128	102	$4,969,463	$4,336,282	87%	$633,181	13%
California	6211	103	$40,209,171	$26,258,258	65%	$13,950,913	35%
Illinois	6126	102	$11,533,722	$11,045,040	96%	$488,682	4%
Kentucky	6141	102	$5,267,770	$5,225,029	99%	$42,741	1%
Michigan	6255	104	$10,244,671	$9,483,087	93%	$761,584	7%
New York	6052	101	$40,517,687	$30,847,324	76%	$9,670,363	24%
North Dakota	6248	104	$718,903	$681,803	95%	$37,100	5%
Oklahoma	6059	101	$3,526,730	$3,489,064	99%	$37,666	1%
Tennessee	6271	104	$7,811,436	$7,643,579	98%	$167,857	2%
Utah	6181	103	$2,007,402	$1,972,361	98%	$35,041	2%
West Virginia	6227	104	$2,261,676	$2,257,863	100%	$3,783	0%
Comparable States Average			**$11,733,519**	**$9,385,426**	**92%**	**$2,348,083**	**9%**

Public Welfare Service

- The structure of public welfare service responsibility sharing between NC's government and its local governments is similar to that of comparable states.
- North Carolina's 86% is close to the average of 92%
- However, eight states assume responsibility for over 93% of total spending

Health and Hospital Services

- Hospital care in other hospitals (public or private) and support of other public and private hospitals;
- Financial support of other public or private hospitals, including construction; payments to private corporations who lease and operate government-owned hospitals; and construction of hospitals to be leased or turned over to others to operate.
- Other public health programs

(*Source: Census of Governments, 2003-04*)

12

Table 3: Health and Hospitals
(dollars expressed in 000)

State	Expenditure Need Per Capita	Expenditure Index	Total Amount	State Amount	State Percent	Local Amount	Local Percent
North Carolina	6113	102	$5,951,428	$1,868,210	31%	$4,083,218	69%
Arizona	6128	102	$2,010,201	$1,136,701	57%	$873,500	43%
California	6211	103	$24,280,746	$7,294,253	30%	$16,986,493	70%
Illinois	6126	102	$5,399,029	$3,502,484	65%	$1,896,545	35%
Kentucky	6141	102	$1,547,411	$1,051,237	68%	$496,174	32%
Michigan	6255	104	$6,820,475	$2,954,876	43%	$3,865,599	57%
New York	6052	101	$13,924,768	$5,226,570	38%	$8,698,198	62%
North Dakota	6248	104	$115,258	$85,242	74%	$30,015	26%
Oklahoma	6059	101	$1,305,255	$502,284	38%	$802,971	62%
Tennessee	6271	104	$3,723,076	$1,304,506	35%	$2,418,570	65%
Utah	6181	103	$1,004,981	$775,070	77%	$229,911	23%
West Virginia	6227	104	$570,155	$306,528	54%	$263,627	46%
Comparable States Average			**$3,642,061**	**$1,684,550**	**53%**	**$1,957,511**	**47%**

Health and Hospital Services

- The state of North Carolina has much less responsibility (31%) than similar states (53%)

Transportation Services

- Includes: Highways, air transportation (airports), parking facilities, sea and inland port facilities, and transit subsidies construction and maintenance.

(*Source: Census of Governments, 2003-04*)

Table 4: Transportation

(dollars expressed in 000)

State	Expenditure Need Per Capita	Expenditure Index	Total Amount	State Amount	State Percent	Local Amount	Local Percent
North Carolina	6113	102	$3,906,056	$3,065,136	78%	$840,920	22%
Arizona	6128	102	$2,705,500	$1,277,886	47%	$1,427,614	53%
California	6211	103	$14,569,283	$5,628,821	39%	$8,940,462	61%
Illinois	6126	102	$5,861,766	$2,450,115	42%	$3,411,651	58%
Kentucky	6141	102	$2,264,425	$1,601,878	71%	$662,547	29%
Michigan	6255	104	$4,388,842	$1,719,434	39%	$2,669,408	61%
New York	6052	101	$10,675,753	$3,709,679	35%	$6,966,074	65%
North Dakota	6248	104	$549,269	$325,500	59%	$223,769	41%
Oklahoma	6059	101	$1,458,238	$773,885	53%	$684,353	47%
Tennessee	6271	104	$1,958,388	$1,167,556	60%	$790,832	40%
Utah	6181	103	$1,151,778	$723,912	63%	$427,866	37%
West Virginia	6227	104	$1,057,289	$950,156	90%	$107,133	10%
Comparable States Average			**$4,238,011**	**$1,848,075**	**54%**	**$2,389,936**	**46%**

Transportation Service

- North Carolina assumes a greater share of responsibility (78%) than similar states (54%)
- Only West Virginia assumes a higher percent of responsibility at 90%

Table 5: Public Safety

State	Expenditure Need Per Capita	Expenditure Index	Total Amount	State Amount	State Percent	Local Amount	Local Percent
North Carolina	6113	102	$3,766,256	$1,498,010	40%	$2,268,246	60%
Arizona	6128	102	$3,333,580	$1,020,033	31%	$2,313,547	69%
California	6211	103	$14,569,283	$5,628,821	39%	$8,940,462	61%
Illinois	6126	102	$5,861,766	$2,450,115	42%	$3,411,651	58%
Kentucky	6141	102	$1,624,188	$660,809	41%	$963,379	59%
Michigan	6255	104	$5,467,987	$1,953,577	36%	$3,514,410	64%
New York	6052	101	$14,904,077	$3,608,810	24%	$11,295,267	76%
North Dakota	6248	104	$204,304	$84,185	41%	$120,119	59%
Oklahoma	6059	101	$1,566,805	$667,662	43%	$899,143	57%
Tennessee	6271	104	$2,487,694	$655,856	26%	$1,831,838	74%
Utah	6181	103	$1,135,024	$465,969	41%	$669,055	59%
West Virginia	6227	104	$564,304	$298,422	53%	$265,885	47%
Comparable							
States Average			**$4,701,728**	**$1,590,387**	**38%**	**$3,111,341**	**62%**

Public Safety Services

- North Carolina's 40% is in line with the average responsibility of other states (38%)

19

Table 6: Environment and Housing

State	Expenditure Need Per Capita	Expenditure Index	Total Amount	State Amount	State Percent	Local Amount	Local Percent
North Carolina	6113	102	$2,744,719	$830,249	30%	$1,914,470	70%
Arizona	6128	102	$2,314,985	$491,490	21%	$1,823,495	79%
California	6211	103	$23,976,699	$4,885,861	20%	$19,090,838	80%
Illinois	6126	102	$6,896,056	$722,630	11%	$6,173,426	89%
Kentucky	6141	102	$1,384,924	$630,095	46%	$754,829	54%
Michigan	6255	104	$4,393,661	$974,629	22%	$3,422,032	78%
New York	6052	101	$10,053,311	$1,313,168	13%	$8,740,143	87%
North Dakota	6248	104	$254,709	$38,259	15%	$216,450	85%
Oklahoma	6059	101	$1,086,079	$276,269	25%	$809,810	75%
Tennessee	6271	104	$1,969,684	$383,125	20%	$1,586,559	80%
Utah	6181	103	$1,150,110	$285,982	25%	$864,128	75%
West Virginia	6227	104	$659,368	$303,381	46%	$355,987	54%
Comparable							
States Average			**$4,921,781**	**$936,808**	**24%**	**$3,985,245**	**76%**

Environment and Housing Services

- North Carolina's 30% is higher than most states.
- Nine states share 25% or less of the total burden
- Only West Virginia and Kentucky share a greater percent of the burden

21

Table 7: Government Administration

State	Expenditure Need Per Capita	Expenditure Index	Total Amount	State Amount	State Percent	Local Amount	Local Percent
North Carolina	6113	102	$1,812,410	$729,419	40%	$1,082,991	60%
Arizona	6128	102	$1,718,120	$447,452	26%	$1,270,668	74%
California	6211	103	$17,821,526	$8,257,941	46%	$9,563,585	54%
Illinois	6126	102	$3,363,093	$1,370,946	41%	$1,992,146	59%
Kentucky	6141	102	$977,567	$640,175	65%	$337,392	35%
Michigan	6255	104	$2,942,463	$812,718	28%	$2,129,745	72%
New York	6052	101	$7,799,872	$4,148,194	53%	$3,651,678	47%
North Dakota	6248	104	$1,047,215	$121,629	12%	$925,586	88%
Oklahoma	6059	101	$1,056,289	$542,755	51%	$513,534	49%
Tennessee	6271	104	$1,320,380	$467,772	35%	$852,608	65%
Utah	6181	103	$1,025,955	$565,845	55%	$460,110	45%
West Virginia	6227	104	$687,821	$438,830	64%	$248,991	36%
Comparable							
States Average					**43%**		**57%**

Government Administration Services

- There is wide disparity in the share of funding in this area ranging from North Dakota's 12% to Kentucky's 65%.

- North Carolina's 40% is close to the average of 43%

23

Table 8: Utilities

State	Expenditure Need Per Capita	Expenditure Index	Total Amount	State Amount	State Percent	Local Amount	Local Percent
North Carolina	6113	102	$3,750,222	$102,399	3%	$3,647,823	97%
Arizona	6128	102	$3,706,026	$28,173	1%	$3,677,883	99%
California	6211	103	$30,601,785	$5,541,795	2%	$25,059,990	98%
Illinois	6126	102	$5,682,357	$0	0%	$5,682,357	100%
Kentucky	6141	102	$1,062,410	$61	0%	$1,062,349	100%
Michigan	6255	104	$2,484,143	$0	0%	$2,484,143	100%
New York	6052	101	$21,171,518	$10,269,625	49%	$10,901,893	51%
North Dakota	6248	104	$96,049	$0	0%	$96,049	100%
Oklahoma	6059	101	$1,117,346	$304,820	27%	$812,526	73%
Tennessee	6271	104	$8,237,346	$4,830	0%	$8,232,516	100%
Utah	6181	103	$1,758,328	$0	0%	$1,758,328	100%
West Virginia	6227	104	$250,957	$14,800	6%	$236,157	94%
Comparable States Average					**8%**		**92%**

Utilities Services

- In most states, local governments assume primary responsibility for these services.

- New York is an outlier in that the state assumes 49% of the responsibility

Table 9: Insurance Trust

State	Expenditure Need Per Capita	Expenditure Index	Total Amount	State Amount	State Percent	Local Amount	Local Percent
North Carolina	6113	102	$3,959,596	$3,939,093	100%	$20,503	0%
Arizona	6128	102	$2,290,229	$2,179,136	95%	$111,093	5%
California	6211	103	$33,044,645	$27,194,376	82%	$5,850,269	18%
Illinois	6126	102	$10,241,385	$7,620,381	74%	$2,621,004	26%
Kentucky	6141	102	$2,462,784	$2,430,915	99%	$31,869	1%
Michigan	6255	104	$6,885,544	$5,627,428	82%	$1,258,116	18%
New York	6052	101	$21,740,492	$14,365,484	66%	$7,375,008	34%
North Dakota	6248	104	$232,766	$223,187	96%	$9,579	4%
Oklahoma	6059	101	$1,117,346	$304,820	27%	$812,526	73%
Tennessee	6271	104	$1,942,004	$1,566,111	81%	$375,893	19%
Utah	6181	103	$937,202	$937,202	100%	$0	0%
West Virginia	6227	104	$1,285,544	$1,257,883	98%	$27,661	2%
Comparable							
States Average					**82%**		**18%**

Insurance Trust Services

- Ten of the eleven states assume at least 74% of the responsibility for these payments with six states (including North Carolina) assuming at least 95% of the costs

State and Local Fiscal Modernization Study Commission

November 29, 2006
AGENDA

8:30 – 9:00 AM	**Issues Inherent in North Carolina's Current Tax Structure**	**Roland Stephen, Assistant Director for Research and Policy, Institute for Emerging Issues**

North Carolina has had the same system of tax and finance since the 1930's. What elements of this system have not kept pace with a changing economy? In what areas is modernization most needed?

9:00 – 9:30 AM	**State Tax Reform: Lessons from Prior Efforts**	**Ben Russo, Professor of Economics, UNC-Charlotte**

The purpose of this presentation is to discuss the basic principles of tax reform, examine previous efforts and compare comprehensive and partial reform, and discuss lessons that can be learned from tax reform efforts in other states.

9:30 – 10:00 AM	**State and Local Responsibilities and Funding: Healthcare Services and Medicaid**	**Mark Holmes, Senior Research Fellow Program on Healthcare Economics an Finance, UNC-Chapel Hill**

The purpose of this presentation is to examine in more detail the state and local responsibilities and funding for health care services and Medicaid and issues inherent in the current structure.

10:00 – 10:15 AM	**Break**	
10:15 – 10:45 AM	**State and Local Responsibilities and Funding: Schools and Education**	**Jack Vogt, Professor of Public Finance and Government, School of Government, UNC-Chapel Hill**

The purpose of this presentation is to examine in more detail the state and local responsibilities and funding for schools and education and issues inherent in the current structure.

10:45 – 11:15 AM	**State and Local Responsibilities and Funding: Transportation and Water and Sewer**	**Kara Millonzi and David Lawrence, Professors of Law and Government, School of Government, UNC-Chapel Hill**

North Carolina is almost unique among the 50 states in that its county governments have no construction or maintenance responsibility for streets or highways. The purpose of this presentation is to examine in more detail the state and local responsibilities and funding for transportation infrastructure and water and sewer infrastructure in North Carolina.

.15 – 11:45 AM	**State and Local Responsibilities and Funding: Courts**	**Jim Drennan, Professor of Public l and Government, School of Government, UNC-Chapel Hill**

North Carolina's current court system is the result of reform efforts that began in the mid 1950s and ended in 1970. The purpose of this presentation is to examine in more detail the state and local responsibilities and funding for the court system and issues inherent in the current structure.

11:45 – 12:30 PM	**Infrastructure Report Card**	**R.D. Odell, American Society of Civil Engineers**

This presentation will summarize the major infrastructure needs of North Carolina as reported in the American Society of Civil Engineers' Infrastructure Report Card.

12:30 – 1:30 PM **Lunch and Adjourn**

Sponsored by the Z. Smith Reynolds Foundation

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State & Local Fiscal Modernization — Nov. 29, 2006

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Cam Cover	BPMH L
Carolyn Minors	NCACC
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Karl Smith	IEI / School of Government
Diane Cherry	Institute for Emerging Issues
Michelle Bodas	Institute for Emerging Issues
Kara Millonzi	School of Government
Owen Franklin	NC League of Municipalities
DAVID THOMPSON	NCACC
Doug Aeron	NC BAR ASSOCIATION
Michael Houser	NCAE
MAURICE MONGKUO	FAYETTEVILLE STATE UNIVERSITY

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Meg Gray	NC Budget & Tax Ctr
Judy Rhyne	NC Assoc. of County Commissioners
Michael Kelly	NC Assoc Co. Comm.
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Issues Inherent in North Carolina's Current Tax Structure

Dr. Roland Stephen
November 29, 2006

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research · ideas · debate · action · leadership

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North Carolina's Future: Opportunities and Challenges

North Carolina: A brilliant future, significant challenges:

- Population Growth: Healthcare, Roads, Infrastructure
- Economic Transformation: K-12, Higher Education
- Financial Modernization: Efficiency, Public-Private Partnership, Reform

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North Carolina Revenue Outlook

- General Fund availability in excess of $2.4 billion this year
- **But:** 80% of that excess was non-recurring (or one time).
- Future revenues look bleak.

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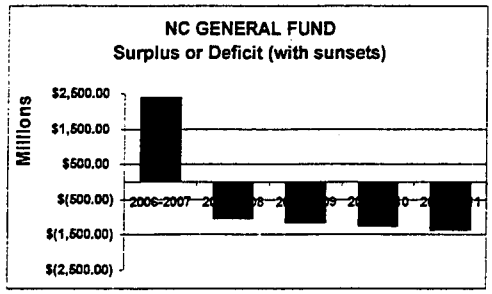
North Carolina's Future Revenue Outlook



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Hard Choices

No magic money tree for the state!

- Reduced costs and increased efficiencies in all programs
- Creative public/private funding partnerships
- Modernization of North Carolina's system of tax and finance

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Hard Choices

Modernization of state system of revenues has two elements:

- Adopt sufficient, stable and fair system of revenues
- Review division of responsibilities between state and local government

The solution cannot be piecemeal

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Framework for Change

Institute for Emerging Issues

Change must meet three requirements:

- Sufficiency
- Efficiency
- Equity

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Framework for Change

Institute for Emerging Issues

Change must be achieved through:

- Balance among sources of revenues
- Broad base
- Low rates
- Targeted social spending

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A Word about Politics

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- Painful political choices are inevitable
- Choices avoided here will be forced on us in other ways
- Change today is likely to be easier than change tomorrow

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Modernizing Tax and Finance

Sales Tax

- Discriminates against manufacturing
- Relies on a shrinking base
- Regressive dependence on goods

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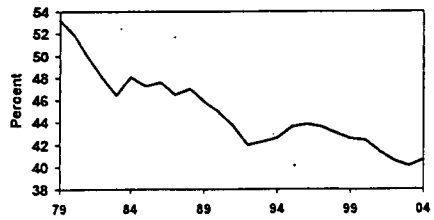
Modernizing Tax and Finance

The sales tax base is shrinking as percentage of the economy.



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Modernizing Tax and Finance

The Income Tax

- Depends on "bracket creep": Unseen tax increase on the middle class
- Volatile: New spending or painful cuts
- Uncompetitive: High rates, often paid by small business

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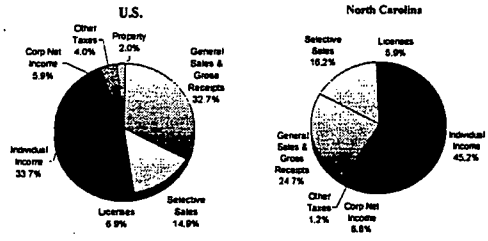
Modernizing Tax and Finance

Institute for Emerging Issues

NC depends heavily on the income tax ...



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Modernizing Tax and Finance

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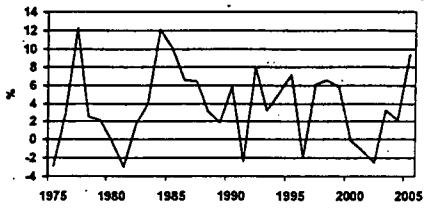
Growth in state revenues is volatile.



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Local Responsibilities and Revenues

Institute for Emerging Issues

The tangled web of state and local finance requires the following:

- Responsibilities and funding should be matched by an appropriate source of revenue at every level of government.
- Systematic reform of local program and service delivery

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State Tax Reform:

General Principles and Lessons from Prior Efforts

Benjamin Russo
Economics Department
UNC at Charlotte

Prepared for the November 29, 2006 meeting of the State and Local Finance Modernization Study Commission

A) Suggestion for a Working Definition of Tax Reform

B) Review Tax Policy Analysts' Principles of State Tax Reform

C) Compare Comprehensive and Partial Reform

D) Brief Review of a Federal Comprehensive Reform: *TRA86*

E) List Steuerle's 'Lessons' from his *TRA86* Experience

F) Brief Review of Hellerstein/Francis Account of Florida's 1987 'Sales Tax Reform'

G) Lessons from Florida and Elsewhere

Too much to do, too little time – Please see unabbreviated version of presentation

A) A Working Definition of Tax Reform

1) Senator Huey Long: Don't tax you, don't tax me…

2) Wikepedia: Process of changing tax collection and management (includes Texas 1991"business tax reform")

3) Americans for Tax Reform: Political philosophy as tax reform

4) Kennedy Administration: Tax cuts for growth (Heller)

5) 1st Reagan Administration: Tax cuts for revenue (Wanniski), smaller government (Stockman), growth, etc.

6) 2nd Reagan Administration: Steuerle says *TRA86* goals were equity, economic efficiency, and simplicity

'Tax Reform' denotes change in the tax system designed to improve

a) Equity

b) Economic Efficiency

c) Simplicity

Continued…

...Continued

7) TR denotes change in the tax system designed to improve Equity, Economic Efficiency, Simplicity

a) Equity

i) tax according to benefits received from government services

ii) tax according to "ability-to-pay"

horizontal equity – equal tax treatment of equals

vertical equity – higher taxes on higher abilities (controversial)

b) Economic Efficiency: "Inefficiency" occurs when taxes alter taxpayer choices, creating economic costs

i) deadweight loss – worse than robbing Peter to pay Paul

ii) economic value flushed down drain

Efficient taxation would reduce deadweight tax losses to the "minimum"

c) Simplicity

i) in administration

ii) in compliance

B) Tax Policy Analysts' Principles of ***State*** Tax Reform (from *Final Report* of 2002 Governor's Commission)

1) Sufficiency: Revenue system that grows with economy in the long run

2) Appropriate Federalism: state/local sharing of revenue/taxing responsibility and authority

3) Competitiveness: Promote long-run economic development, job creation, growth

4) Equity

5) Economic Efficiency

6) Simplicity

C) Comprehensive versus Partial Reform (from Bruce, *Public Finance and the American Economy*)

1) Comprehensive reform would improve the tax system by changing the "structure" of the tax system or replacing it entirely (tax base, deductions, exemptions, exclusions, etc.)

2) Partial reform would improve the tax system by targeted changes in details of the existing structure

3) Steuerle argues comprehensive federal tax reform rarely is achieved

4) Fox et al. argue comprehensive state tax reform rarely is achieved

5) Above analysts tend to focus on post-WWII era, and exclude

a) 1913 federal Income Tax Act

b) North Carolina revenue reform

i) 1849
ii) 1921
iii) 1931-33

D) Federal Comprehensive Reform: *TRA86*

1) Principles

a) Improve equity, efficiency, simplicity
b) *NOT* to cut tax rates, increase growth, change level of revenue

2) General approach

a) Remove low income families from tax roles
b) Revenue neutral
c) Broaden tax base
d) Cut tax rates (a contradiction?)

3) Select details

a) Equity

i) horizontal – broaden tax base by reducing itemized deductions, exclusions, tax shelters
ii) vertical – increase personal exemption/standard deduction, excluding millions from tax roles

b) Efficiency

i) reduced highest personal marginal income tax rate 50% to 28%, highest corp. rate 46% to 34%
ii) broaden tax base by reducing itemized deductions, exclusions, tax shelters

c) Simplicity: reduce itemized deductions, exclusions, tax shelters. But removing shelters requires rules

E) Steuerle's Lessons from *TRA86* Experience

1) Listen!

2) Know the forces at play (understand root causes)

3) Have an overall vision

4) Start with principles (work top down)

5) Balance principles

6) Seek bipartisan consensus

7) Plan snapshots (presentation to public)

8) Acknowledge reform involves losers

9) Work bottom up as well as top down (deal with tedious details)

10) When stuck between camps, work on common concerns

Please see unabbreviated version, and/or Steuerle's article

Possible # 11) Create mechanisms to periodically monitor tax law conformity to principles & economy (Hawaii)

F) Hellerstein/Francis Account of Florida's Sales Tax Reform

1) Principle (my interpretation) – expand tax base to correct insufficiency

2) General approach: extend Florida's general sales and use tax to most services

3) Some specifics

a) Taxed services

i) Accounting, advertising, contracting, legal services (et al.)
ii) Services were taxable if sold in Florida
iii) Use of services in Florida taxable even if services purchased outside Florida

b) Exempt services

i) Agric., educ., govt., health, sanitary, social, and religious services, et al.
ii) Services purchased in Florida but used elsewhere

4) Chronology

6/1986: Legislature passes law extending sales/use tax beginning in 1987 ("surprising little resistance")

1986:	Bob Martinez campaigns on an anti-tax platform
Early 1987:	Governor Martinez reverses position, supports sales/use tax on services
4/1987:	Governor signs legislation extending sales/use tax to services
7/1987:	Tax takes effect. Vigorous media criticism begins in earnest
9/1987:	Governor reverses position, opposes sales/use tax on services
12/1987:	Sales/use tax on services repealed

G) Lessons from Florida and Elsewhere

1) Francis:

a) Extend sales/use tax comprehensively to all services (enumerate exempted services)

b) Find a way to make the media's self-serving anti-tax message be seen for what it is

c) Pro-reform coalition must proceed on a consensus basis before and after enactment

2) Many tax analysts agree principles should apply to the tax ***system***, not individual parts

3) Feldstein & Stiglitz: whatever shortcomings of current tax system, taxpayers have adjusted. Ease transition to new system by gradually introducing reforms

4) Steuerle's Guideline 3 – 'Have an Overall Vision'

Revenue neutral tax reform that broadens tax base & lower tax rates

Possible # 5) Horizontal equity first, then tax structure, then vertical equity

Thank you and good luck

State Tax Reform:

General Principles and Lessons from Prior Efforts

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Prepared for the
State and Local Finance Modernization Study Commission

I) A Definition and General Principles of Tax Reform

A. Working definition of "tax reform"

1) It is useful to have a definition of tax reform that defines the goals of reform. If we do not know where to aim, we're likely to miss our target. But there is no single set of necessary and sufficient conditions commonly used to distinguish what is, from what is not, tax reform. Tax policy analysts are not lexicographers with authority to dictate usage. Nevertheless, many tax policy analysts with practical experience in tax reform arenas follow a common approach that provides a working definition that establishes criteria, or principles, of an economically desirable tax system. This section reviews some well known descriptions of tax reform, some objections, and the tax policy analyst working definition.

2) Former Louisiana senator Huey Long famously stated tax reform means "don't tax you, don't tax me, tax the fellow behind the tree." The advantage of this definition is that it includes a measure of success: Tax reform is accomplished when the tax system shifts the tax burden to others outside the relevant tax jurisdiction. The difficulty with this approach is that the others have an economic incentive to resist the effort. The 1930 Smoot-Hawley tariff, an example of 'beggar-thy-neighbor' policy, provides an example.[1] Other countries retaliated by increasing tariffs on U.S. exports. World trade seized up, making all countries involved worse off.[2]

3) Wikipedia (the online encyclopedia) defines tax reform as the process of changing the way taxes are collected or managed by government. The advantage of this definition is that it is easy to know when reform has been achieved: Nearly every change in the tax system fits this definition. For example, in 1991 the Texas Legislature "eliminated" that state's tax on corporate income. More precisely, Texas relabeled its corporate tax a 'franchise tax.' The problem with this definition is that if everything is tax reform, the term is meaningless, providing no useful guide to improving the tax system.

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[1] Beggar-thy-neighbor policy is designed to improve one's own lot at the expense of someone else's.

[2] After imposition of Smoot-Hawley U.S. imports from Europe declined from $1.3 bi. in 1929 to $0.4 bi. in 1932. U.S. exports to Europe fell from $2.3 bi. in 1929 to $0.8 bi. in 1932. World trade declined about 66%. Source - http://www.state.gov/r/pa/ho/time/id/17606.htm.

4) The tax cut advocacy group Americans for Tax Reform defines reform as a change in taxes that reduces the level of tax revenue. However, there is no necessary relationship between the level of revenue and the ability of a tax system to attain desirable social goals: Small governments can have poorly designed tax systems, and large governments can have well designed tax systems. What is needed is a set of criteria for good design.

5) Major changes in federal taxes legislated in the early 1960's and the early 1980's often are referred to as tax reform. In the 1960's the Kennedy Administration enacted an Investment Tax Credit on machinery and equipment (*ITC*), and reduced the highest marginal tax rate on personal income from 91% to 70%. In the early 1980's, among other things, the Reagan Administration reduced the highest marginal tax rate on unearned income from 70% to 50%, and introduced many changes in the tax system that permitted taxpayers to shelter income from taxes.[3]

6) The reported goal of the Kennedy Administration was to use deficit-finance to "get the country moving again." That is, the goal was a short term increase in the rate of economic growth.[4] A problem with using growth as the goal of tax reform is that doing so tends to give the misleading impression that tax reform has only benefits. But growth has costs, such as congestion, the need for new infrastructure, and possible environmental impacts. Second, it is very difficult to identify an empirical relationship between taxes and growth, so it is impossible to know if the reform achieves its goal. Third, this says nothing about other important social impacts taxes have, for example on equity and economic efficiency. The Urban Institute's Eugene Steuerle, one of the architects of the Tax Reform Act of 1986 (*TRA86*), says that when growth is used to justify tax changes, it tends to dominate the debate, pushing all other laudable tax reform objectives out of the discussion.[5]

7) Early in the Reagan Administration tax reform appeared to be identified with tax cuts. The advantage of this position is that achievement of reform is clear: the tax rate is lower than before. However, if tax cuts were a viable goal, the optimal reform would cut the rate to zero. Because no true economic goal of reform was articulated by proponents of the 1981 Economic Recovery and Tax Act (*ERTA*) confusion over goals was widespread. One faction argued the tax cuts would increase growth, thereby increasing revenues: tax cuts would pay for themselves. Other participants suggested *ERTA's* true goal was to reduce revenue, and force a reduction in the size of government. 'Tax cuts' overpowered every other goal of true tax reform. The result has been described as a tax cut feeding frenzy. Effective tax rates on some activities became negative, creating economic incentives to undertake those activities for no purpose other than to shelter income from taxes. Such special treatment ends up treating equals differently, and encourages

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[3] For example, *ERTA* increased opportunities for safe-harbor leasing, allowing firms with no taxable income to benefit from accelerated depreciation allowances by selling their capital to profitable firms, and leasing it back. *ERTA* also increased opportunities for investors to use capital losses on passive investments (where the principle is not actively involved in a business) to reduce ordinary taxable income, and thereby reduce tax liability.

[4] James Tobin, a principle advisor to the Kennedy Administration, suggested the tax cut was unlikely to produce substantial change in long run growth.

[5] Steuerle, 1999, "Tax Reform, Federal," *The Encyclopedia of Taxation and Tax Policy* (Urban Institute Press: Wash. DC).

taxpayers to divert resources and energy away from productive activity toward activities designed to reduce tax bills.[6]

8) As early as Adam Smith's *The Wealth of Nations*, tax policy analysts enumerated criteria, or principles, of an economically sound tax system.[7] Smith's list included equity and simplicity. He did not include economic efficiency as a separate principle: however, Smith's discussion makes clear that he regarded efficiency as a fundamental principle of sound taxation.[8] Thus, tax policy analysts Donald Bruce, Steven Gold, and Eugene Steuerle, define tax reform as a change in the tax system designed to improve ***equity***, ***economic efficiency***, and ***simplicity***.[9]

9) Equity, Economic Efficiency, and Simplicity

a) Equity: Two fundamental principles govern most tax analysts' discussions of equity. These are, first, the benefits principle, and second, the ability-to-pay principle. When the benefits principle is applied, citizens pay taxes according to identifiable benefits each receives from government services. This can work for a small set of specific services, such as transportation. The benefits principle cannot be implemented where individual benefits are hard to identify, such as in the cases of criminal courts and prisons. The ability-to-pay principle is applicable in the hard-to-identify cases. When the ability-to-pay principle is applied, citizens who have equal abilities are taxed equally, ('horizontal equity'), and citizens with higher abilities are taxed relatively heavily ('vertical equity').

b) Economic Efficiency is the least intuitive principle of taxation, and usually requires some explanation. It is best understood by considering its opposite, inefficiency.

i) Inefficiency occurs when taxes alter taxpayer choices, reducing economic value. For example, colonial England imposed a tax on windows. Afterward, the English built houses with fewer windows. Houses with fewer windows have lower value. The decrease in economic value is a "deadweight loss;" that is, a cost to some taxpayers not offset by benefits to anyone. This is worse than taxing Peter to pay Paul, which at least makes Paul better off. Deadweight tax loss is economic value flushed down the drain. It has been likened to burning money. Tax inefficiency occurs because taxes provide incentives for taxpayers to spend time and other scarce resources to avoid taxes, rather than in

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[6] According to Frederick Mishkin, a current member of the Board of Governors of the Federal Reserve, *ERTA's* special treatment of real estate investment contributed to a real estate boom, which, in turn, contributed to the Savings and Loan Crisis. See Mishkin's *The Economics of Money, Banking, and Financial Institutions.*

[7] An economically sound tax system is one that adheres, as closely as possible, to the principles that: 1) individuals trading in markets are the best judges of their own interests, 2) markets fail in important ways, and 3) the government has a potential to correct market failures, and improve social welfare.

[8] In fact, economic efficiency is the central them of *The Wealth of Nations.*

[9] Bruce is a University of Washington tax policy analyst and author of *Public Finance and the American Economy.* Gold and Steuerle are tax analysts for The Urban Institute in Washington DC.

production and consumption. For example, a sufficiently high payroll tax could discourage work effort or may encourage payment to professionals expert at shifting salary into tax shelters.

ii) A relatively efficient tax system would reduce deadweight tax losses to the minimum amount consistent with achievement of the other principles.

c) Simplicity means ease in compliance with, and administration of, the rules governing taxation.

10) Steuerle uses the term "*systematic*" tax reform to distinguish the tax analysts' definition of tax reform from other views. He points to the Tax Reform Act of 1986 (*TRA86*) as an example of systematic tax reform. *TRA86* was designed to improve equity, reduce inefficiency, and simplify the federal tax system. It was not designed to encourage economic growth, cut taxes, change the system for the sake of change, or increase or decrease the level of revenue (in fact, it was designed to be revenue neutral).

B. Principles of state tax reform

1) Bruce, Gold, and Steurele define tax reform in terms of fundamental principles of a sound tax system, namely equity, efficiency, and simplicity. These are core principles that apply to taxes at all levels of government. But state and local finance faces many knotty issues not faced at the federal level. Therefore state and local tax policy analysts cite additional principles of sound state tax policy that can usefully guide state tax reform.

2) Revenue sufficiency is an additional principle that is fundamental in a well designed state tax system. A sufficient revenue system grows with the economy in the long run. Sufficiency is fundamental because none of the other economic goals of reform is likely to be achieved if the tax system does not provide sufficient revenue to meet state and local funding requirements. If the tax system is insufficient, the state budget will experience periodic or persistent financial crises. During financial crises, the need to balance the budget dominates debate and tends to sweep aside other laudable goals of a sound tax system.

3) Sharing of fiscal responsibilities between state and local authorities is another principle important at the state and local level. State governments have a comparative advantage in collecting some forms of revenue, such as income taxes, which would be prohibitive for an individual local government. And local governments appear to have the advantage collecting real property taxes. Many observers suggest a similar dichotomy on the spending side of the balance sheet. The way revenue responsibility is shared between state and local governments must be a paramount concern in design of a sound state tax system.

4) The competitiveness of a state's industries and workers is an additional important issue in tax reform.[10] A competitive revenue system promotes long-run economic development, job creation, and growth.

5) Many additional goals of state and local finance design have been cited.[11] However, there is no consensus on the additional goals. For example, the Advisory Commission on Intergovernmental Relations (*ACIR*) argues that balance among tax bases (property tax, income tax, sales tax) should be a goal of tax reform: that is, each tax base should raise approximately the same fraction of total revenue. Against this, Duke University economist Helen Ladd argues that if balance is an objective at all, it should be balance between the other goals (mentioned above) not between tax bases.[12] In contrast, setting taxes so that each base contributes equally to revenue could impair the ability to meet more fundamental economic goals of reform.

6) Many tax analysts and the *Final Report* of the 2002 Governor's Commission to Modernize State Finances suggests the following set of principles:[13]

i) Sufficiency: A revenue system that provides funds over time to satisfy government requirements, with minimum variation in the level of funds, year to year.

ii) Appropriate Federalism: A division of state/local revenue, and an allocation of taxing authority, consistent with each government's abilities, needs, and responsibilities.

iii) Competitiveness: A tax system that promotes long-term, sustainable, economic development, job creation, and growth.

iv) Equity

v) Economic Efficiency

vi) Simplicity

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[10] I believe an economically efficient tax system will be competitive, and an inefficient system will not be. However, many thoughtful tax policy analysts argue that competitiveness and efficiency should be treated as separate principles.

[11] The National Conference of State Legislatures (*NCSL*) describes no less than ten goals (http://www.ncsl.org/programs/fiscal/fpphqsrs.htm). Long lists are unwieldy and violate the principle of simplicity. The principle of parsimony suggests a focus on fundamentals.

[12] Ladd, 1988, "The Meaning of Balance for State-Local Tax Systems," in *The Unfinished Agenda for State Tax Reform*, edited by Steven D. Gold (NCSL: Wash. DC) pp. 31-46.

[13] With apologies to *Final Report* authors, I have changed the order and description of some goals, for the sake of this article. The *Final Report* is available at http://www.osbm.state.nc.us/files/pdf_files/final_rpt_gov_comm.pdf.

7) These considerations suggest the following definition of state tax reform:

> ***State Tax reform is a change in a state's tax system designed to improve sufficiency, advance federalism, and improve competitiveness, equity, economic efficiency, and simplicity***

8) Unfortunately, no single tax base can achieve all these goals simultaneously: A tax reform that moves the system closer to one goal often moves it away from others. For example, many tax policy analysts argue that shifting from an income tax base to a consumption tax base would increase economic efficiency, because the former tends to discourage savings and investment and the latter does not. However, it also is argued that shifting from an income to a consumption tax base could tend to reduce equity because consumption taxes tend to be regressive. Inconsistent goals create a (taxing) dilemma:

> a) There is at least one major exception to the dilemma, namely broadening the tax base and reducing tax rates. Everything else constant, lower tax rates are relatively efficient. Financing rate reduction by broadening the tax base could improve fairness by reducing tax discrimination against some activities, and by increasing progressivity. For example, eliminating some itemized income tax deductions would broaden the income tax base, allowing revenue to be raised at lower tax rates. At the same time, progressivity would be increased because relatively well off taxpayers tend to benefit most from itemized deductions.
>
> b) The fact that some changes improve performance in one dimension while reducing it in others suggests that the principles should be applied to the tax *system* as a whole, not to each part separately. For example, if a reformer adamantly resists any single change in the tax system that would impair a favored principle, there would seem to be no room for compromise. However, it is possible to move the *system* closer to both goals at once by trading off movements toward goals. For example, broadening the sales tax base would tend to improve efficiency, but might reduce progressivity. As well, increasing the income tax's standard deduction would make the system more progressive, but would necessitate higher tax rates (to achieve a given level of revenue) reducing efficiency. Neither of these reforms by itself is capable of making the tax system more equitable and efficient. However, by carefully calibrating the two reforms simultaneously the *system* could be made more equitable and efficient.

II) Lessons From Prior Efforts

A. Comprehensive versus partial tax reform

1) Once goals have been established, the question remains how far should tax reform actually be implemented. Some tax policy analysts argue in favor of comprehensive tax reform. Bruce (2001) defines comprehensive reform as change in the tax system that alters the entire structure of the system, or replaces it entirely. Tax structure includes the tax base, that is, the economic activity or benefit taxed (E.G., consumption, income, or

property), as well as permitted exemptions, exclusions, deductions, and special provisions. For example, *TRA86* often is referred to as a comprehensive tax reform because it reduced exclusions of saving and investment, thereby shifting the tax base toward income.

2) Others analysts argue in favor of partial reform. Partial reform is a targeted change in details of the existing tax structure that leaves the basic structure intact. For example, the 2003 federal tax reductions for capital gains and dividends decreases tax rates on capital income without altering the basic structure of the federal tax system.[14]

3) Note that highly respected tax analysts, such as William Fox, Director of the Center for Business and Economic Activity, and John Mikesell, an Indiana University professor of public and environmental affairs, suggest comprehensive reform has not often succeeded at the state level. I respectfully submit that this point of view may be restricted to the recent past (since WWII). Otherwise, the 1913 federal income tax, and North Carolina's shift from property taxes to state income taxes in the early Twentieth Century would not qualify as successful comprehensive reform.

B. An example of comprehensive federal tax reform

TRA86 has often been held up as a paradigm of comprehensive implementation of tax reform. Among other things, *TRA86*

1) increased personal exemptions and the standard deduction sufficiently to remove millions from the federal income tax roles.

2) reduced the highest federal individual marginal income tax rate from 50% to 28%.

3) reduced the highest federal corporate income tax rate from 46% to 34%.

4) eliminated or reduced many exclusions, deductions, and tax shelters.[15]

C. Steurele's guidelines

Eugene Steuerle served as economic coordinator of the *TRA86* effort. Here are his guidelines for systematic tax reform, along with brief notes:[16]

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[14] The title of the act is Jobs and Growth Tax Relief Reconciliation Act of 2003.

[15] Among other things, *TRA86* eliminated the *ITC* for machinery and equipment, eliminated a 60% exclusion of capital gains, rolled back accelerated depreciation schedules instituted in 1981, reduced depletion allowances for oil and gas, eliminated the 10% income exclusion for dual-earner households, reduced opportunities for safe-harbor leasing, and reduced the ability some investors had to use capital losses on passive investments (where the principle is not actively involved in a business) to reduce ordinary taxable income.

[16] Steurele's article is short but full of insight. See Eugene Steuerle, Dec. 12, 2002, "Ten Guidelines for Systematic Reform, *Tax Notes* (Wash DC: Urban institute), www.urban.org/Template.cfm?NavMenuID=24&template=/TaggedContent/ViewPublication.cfm&PublicationID=8330

1) *Listen* (take the observations, insights, and objections of staff seriously because the tax system is too complicated for any one person to understand.)

2) *Know the Forces at Play* (know and deal with the major difficulties facing the tax system)

3) *Have an Overall Vision* (the tax system and individual interests are so complicated that it is easy to become distracted with minor side issues. Reform should begin with a view of what is achievable and most important to pursue).

4) *Start with Principles* ("only principles can provide a guiding beam, allowing people to judge whether they are on course or not")

5) *Balance Principles* ("...legitimate principles compete with each other. The trick is establishing and maintaining some reasonable balance. Without this balance, reform will get shot down for its failure on one front even if it is successful on another.")

6) Seek some Bipartisan Consensus ("major reform almost always requires some bipartisan consensus... ")

7) *Plan your Snapshots* ("Often a few pictures or symbols in the public's mind will sell or kill reform.")

8) *Acknowledge Reform Involves Losers* (Systematic reform can't dodge the tax goal balance sheet. Achievement of some goals tends to make some people worse off. "One of the ways systematic reform gets killed is the unwillingness to acknowledge this unpleasant fact of economic calculus.... The only way to avoid this downward spiral is to beat the naysayers to the punch..." So admit up front that that there will some losers among those unduly favored by current tax provisions.)

9) *Work Bottom Up and Top Down* (starting with and sticking to principles works from the top down. It also is vital to work from the bottom up, going through the tedious detail of the tax system to get things right.)

10) *When Stuck Between Camps, Work on Common Concerns* (The *TRA86* tax reform effort often got stuck, and at one point ground to a halt for lack of direction. Steuerle says it regained momentum when the divisive issues were momentarily set aside, and attention was shifted to areas where there was common ground.)

More than one observer has noted that many of the 1986 reforms have been eroded by subsequent legislation. For example, special treatment of capital gains eliminated by *TRA86* was resurrected by the 1997 Taxpayer Relief Act. Any realistic assessment of past tax reforms must acknowledge that reforms do not last forever. This should not be surprising. First, special interests that create the need for tax reform in the first place remain after reform is achieved: but the enthusiasm and energy level of reformers often falls off and is hard to sustain. Second, even if the special interests were permanently

defeated, the tax system must change because the economy evolves. Natural evolution in the economy inevitably transforms the state-of-the-art into obsolescence. These observations suggest an additional guideline:

11) Anticipate self-interested as well as evolutionary pressure on reforms, and describe mechanisms to periodically monitor tax law changes for conformance to principles and to modernization of the economy. In a democratic society with a technologically advancing economy, eternal vigilance may be a price of a sound tax system.[17]

D. An example of state comprehensive tax reform

1) I believe the principles of state tax reform enumerated above provide a strong argument in favor of sales taxation of services. However, Florida attempted a comprehensive extension of its general sales tax to services in 1987, and failed. This section describes two accounts of Florida's experience. These accounts can be instructive, first, because they offer insight into what a tax on services could look like. Second, and more generally, these accounts offer insight into how and why a well initiated state tax reform can fail.

2) James Francis, past Director of Research in Florida's Revenue Department, helped construct Florida's sales tax on services.[18] Walter Hellerstein helped draft Florida's sales tax law and served as legal counsel to Florida's Department of Revenue.[19] Here is my rendition of their discussions about what transpired. To aid interpretation of the flow of events, they are presented in rough chronological order:

a) Francis: In *June 1986* Florida's legislature expressed its intent to extend the sales tax base, beginning in 1987. At first, the legislation garnered surprisingly little resistance. Francis argues there were three reasons for this: First, the idea of closing sales tax loopholes had been discussed in Florida's General Assembly for the preceding two years, so the public was educated about the issue, which became popular. Second, increased demand for government services, stemming from economic growth, tended to reduce resistance. Third, the June 1986 legislation was written as a sunset provision, which disarmed reform opponents.

b) Hellerstein:

i) Bob Martinez campaigned for Governor on an anti-tax platform, and was elected in 1986. However, as governor Martinez changed his position, and supported comprehensive extension of Florida's general sales and use taxes to services. In April 1987 Governor Martinez signed legislation extending the sales and use tax to services. The tax took effect July 1, 1987.

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[17] Hawaii's tax laws include a provision requiring a tax commission to re-examine the tax system every five years.
[18] Francis, 1988, "The Florida Sales Tax on Services: What Really went wrong," in *The Unfinished Agenda for State Tax Reform*, edited by Steven D. Gold (NCSL, Wash. DC), pp. 129-152.
[19] Hellerstein, 1988, "Florida's Sales Tax on Services," *National Tax Journal*, pp. 1-18.

ii) The Florida sales tax reform extended the sales and use tax to accounting, advertising, contracting, and legal services. In general, services were taxable if sold in Florida. The use of services was taxable if the services were sold outside the state, but used in state, and if the sale or use was not taxed in another state. Services performed in state for use outside the state were exempt. The sale or use of multistate firm services used partly in Florida was apportioned. There were exemptions for agriculture, education, government, health, local and suburban personal transportation, occasional or isolated sales by persons not engaged in business, and sanitary, social, and religious services.

iii) After the legislation passed, the sales tax extension became embroiled in controversy. Media groups claimed that taxing advertising services violated the First Amendment. Lawyers' associations argued that taxing legal services violated constitutional rights to assistance of counsel. "Out of state purchasers of services claimed that the tax violated the Due Process and Commerce Clauses." (page 10) National advertisers and advertising media launched a vigorous, well-financed, campaign against the tax. Large advertisers reduced advertising in Florida. And media trade associations canceled conventions there.

iv) By September 1987 the Governor's position again turned one-hundred and eighty degrees. In December 1987 Florida's legislature repealed the tax, and Governor Martinez immediately signed the repeal.

c) Francis again:

When vigorous resistance arose, the most heavily criticized feature was the use tax on services. The real bone of contention for multi-state business was not the tax per se, but compliance costs. Services would be apportioned. This startled taxpayers accustomed to the all-or-nothing delivery rules for sales taxation of goods. And apportionment of the sales tax on business services may have implied a widening of "nexus" in some minds.

Francis concludes the tax eventually failed to stick for the following "logistical" reasons: First, the governor's campaign rhetoric handed opponents an anti-tax message. Second, the media was aggravated by inclusion of taxation of advertising services, and bombarded the public with that message (advertisers commissioned a study claiming sales tax extension would eliminate 46,000 jobs). Third, poorly conceived responses by leaders of both parties caused the reform coalition to dissolve.

E. Lessons

1) As a result of the Florida experience, Francis offers the following advice:

a) Two ways to extend sales tax to more services are i) enumerate each specific service to be taxed, or ii) extend the sales tax comprehensively to all services, and enumerate services to be exempted from the tax. Francis argues that the first "piecemeal" approach does not work because the politically tough measures won't be taken.

b) Reformers wishing to extend sales tax comprehensively to services should seek a way to make the media's self-serving anti-tax message be seen for what it is.

c) The pro-reform coalition must proceed on a consensus basis before and after enactment.

2) Many careful observers of tax reform efforts suggest that the principles should be applied to the whole tax system, not its individual tax bases. This is because each and every tax base fails to satisfy one or more principles. Together, however, the combination of all tax bases is capable of moving the system closer to all goals. This is consistent with Ladd's and Steuerle's admonitions that balance be sought in achieving principles. Just as a well designed portfolio of assets balances risk and return, a sound portfolio of tax bases balances equity, efficiency, simplicity, et al. I believe this approach favors comprehensive reform.

3) Martin Feldstein, President of the National Bureau of Economic Research, and Joseph Stiglitz, Nobel prize winning economist, argue that reform tends to be difficult to achieve because taxpayers have already adjusted many economic decisions, and have committed resources, on the basis of the existing tax system.[20] Thus, tax reform always produces economic losses for some taxpayers. Feldstein and Stiglitz suggest that reforms be introduced gradually, so taxpayers have time to adjust; and that reforms should be as transparent as possible, so taxpayers can understand their economic consequences.

4) Steuerle's Guideline 3 is Have an Overall Vision. I suggest the vision could be a revenue neutral systematic tax reform that broadens the tax base and lowers tax rates. Declaring the change will be revenue neutral can soften the charge that tax reform is a smokescreen for increasing the amount of revenue. As well, base broadening with lower rates may be the single reform with potential to improve both equity and efficiency, two of the most divisive issues in tax reform.

5) Ability-to-pay often is held up as the appropriate basis for equitable taxation. Taxation according to ability-to-pay sets two standards. Horizontal equity holds that citizens with equal resources should be taxed equally. Vertical equity holds that citizens with relatively greater economic resources should be taxed relatively heavily. Almost all

[20] Feldstein, 1976, On the Theory of Tax Reform, *Journal of Public Economics*, pp. 77-104; Stiglitz, 2000, *Economics of the Public Sector* (New York: WW Norton & Company).

stakeholders and analysts agree about what horizontal equity requires. However, there appears to be a thoroughgoing lack of consensus on what vertical equity requires. Therefore well-meaning tax reformers often disagree strongly about what is required for a tax system to achieve vertical equity. In this case, Steurele's Guideline 10, (When Stuck Between Camps, Work on Common Concerns) could be an aid to progress. One approach would be to focus initial discussions of fairness on horizontal equity. Construct tax reform on this basis. Leave discussion of vertical equity, namely tax exemptions and the gradient in tax rates, until after the basic tax structure has been agreed upon.

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State and Local Responsibilities and Funding for Medicaid and Other Health Care Services

State and Local Fiscal Modernization Study Commission
November 29, 2006

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Overview

- Healthcare Services
- State healthcare expenditures
- County/State Partnerships

Healthcare Services Provided by (Some) State and Local Governments Nationally

- Medicaid (non-federal share)
  - Traditional Medicaid
  - SCHIP: State Children's Health Insurance Program ("NC Health Choice")
- Employee Benefits
- Public Health
- Hospital/uncompensated/indigent care
- Mental Health
- Corrections
- Higher Education (uncompensated care)

Medicaid: A Federal, State, County Partnership

- Medicaid is a state-administered program that is partially funded by the federal government
- FMAP – Federal Medical Assistance Percentages – varies across states based on state poverty level.
- In 2007, federal share will be 64.52%, remainder (state and county) share will be 35.48%. NC counties pay roughly 5 percent of the total, leaving about 30% for the state.

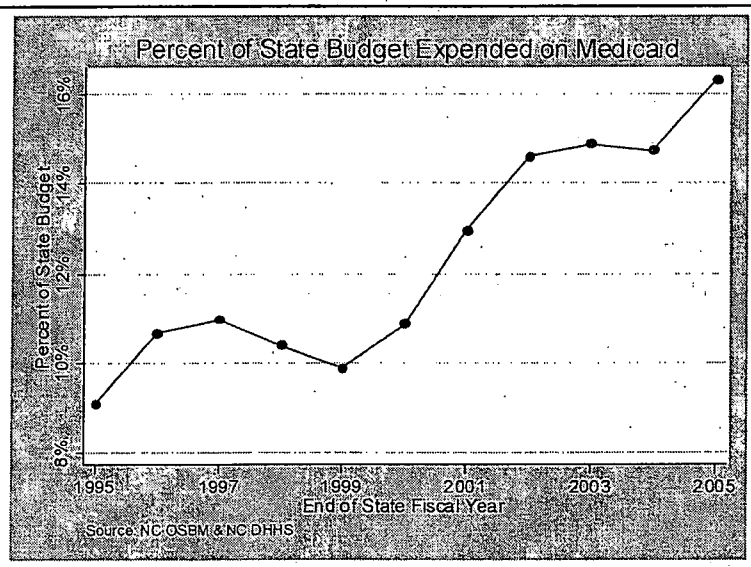
Medicaid trends over time

- Expenditures on Medicaid have increased over the past decade
  - Overall (nominal)
  - Real dollars ($2005)
  - Percent of state (federal, county) budget
  - Per resident
  - Per beneficiary
- Trend not limited to North Carolina
  - Similar challenges across the country

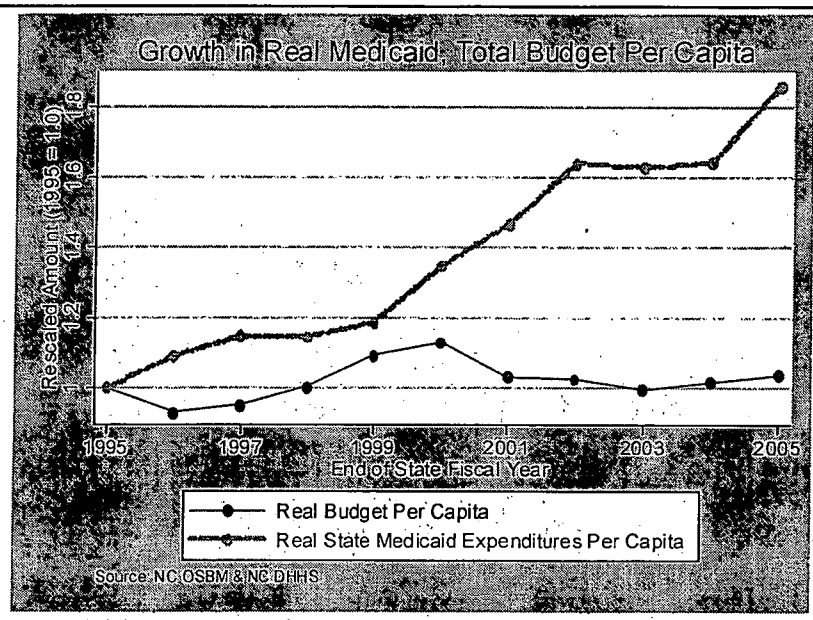
An aside: Healthcare costs are going up

- The increase in Medicaid expenditure should not be interpreted as an indictment of the program. Healthcare costs are increasing across all sectors.
  - Inflation in healthcare sector 1995-2005 = 42%, nearly double overall inflation (28%)
  - Real price of health insurance increased roughly 54 percent 1996-2005
  - Average HI premium for government employees nearly doubled from 1996-2004 ($2194 to $4291)

State expenditures



In 1994-1995, approximately 9 percent of the state budget was expended on Medicaid. In 2004-2005, it was over 16 percent.

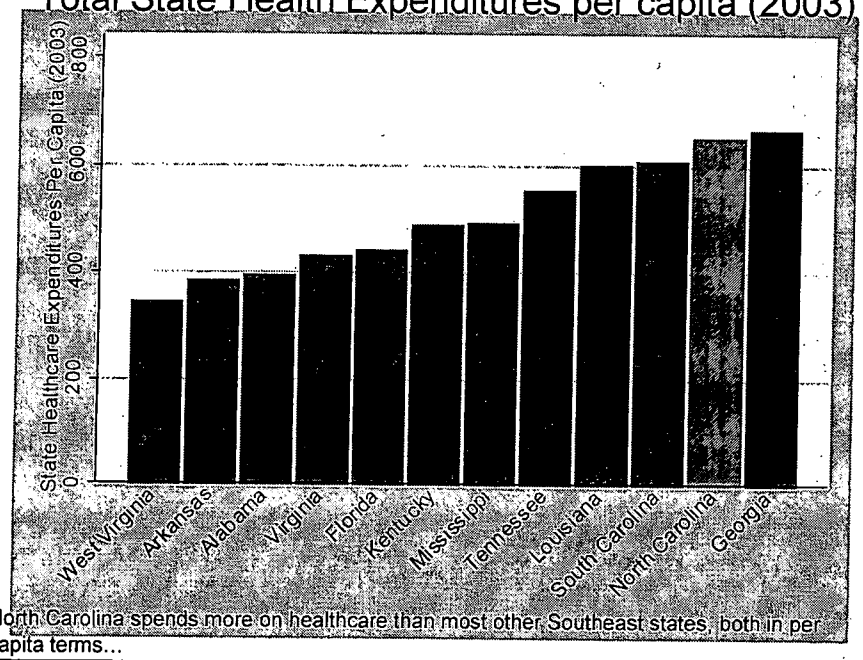


In real dollars per North Carolinian, the budget has been relatively flat. Medicaid expenditures have increased over eighty percent.

Comparison of NC to other states

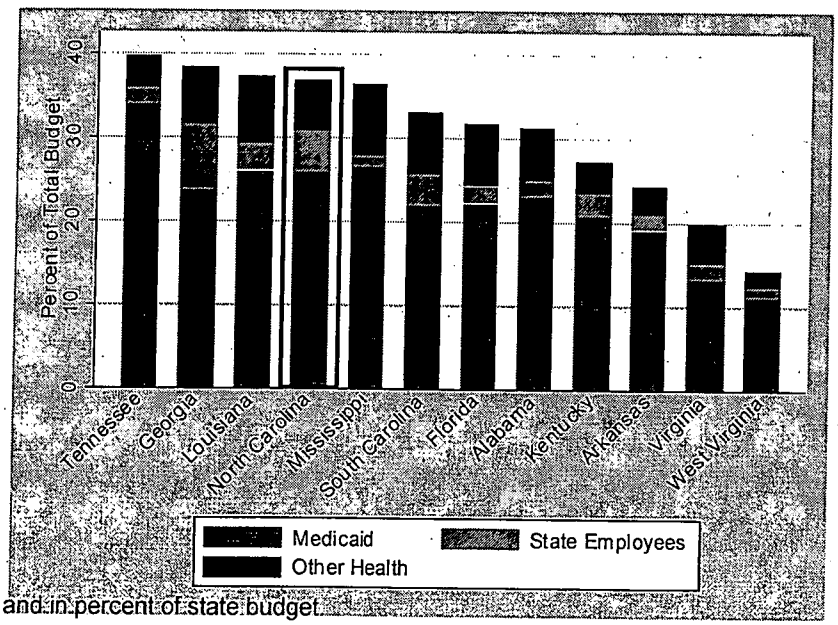
- The Millbank Fund and the National Association of State Budget Officers collaborated on the *2002-2003 State Health Expenditure Report* to analyze budgets of all states for healthcare expenditures
- **How do NC state expenditures compare to our neighbors (AL, AR, FL, GA, KY, LA, MS, SC, TN, VA, WV)?**
- Because of varying state sizes, standardize to per-capita expenditures.
- *Note most recent data are from SFY 2003.*

Total State Health Expenditures per capita (2003)



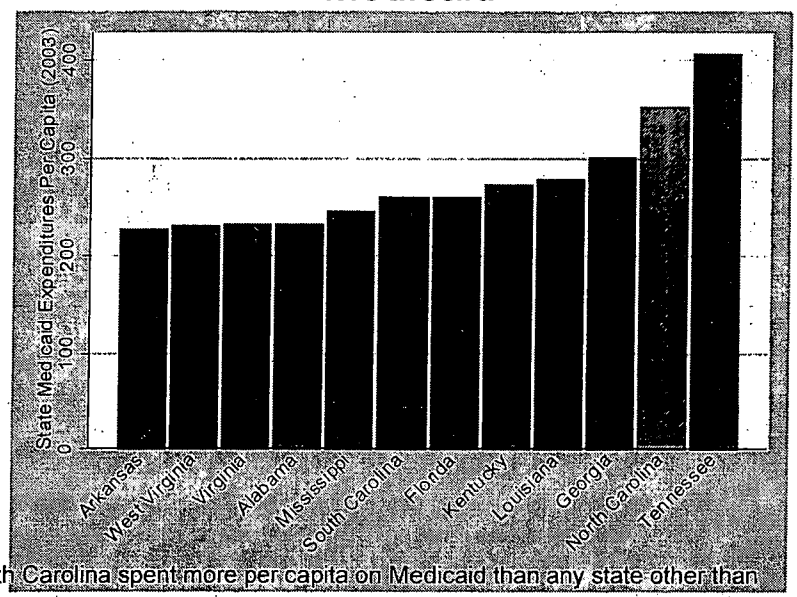
North Carolina spends more on healthcare than most other Southeast states, both in per capita terms...

Share of 2003 SFY Budget on Healthcare



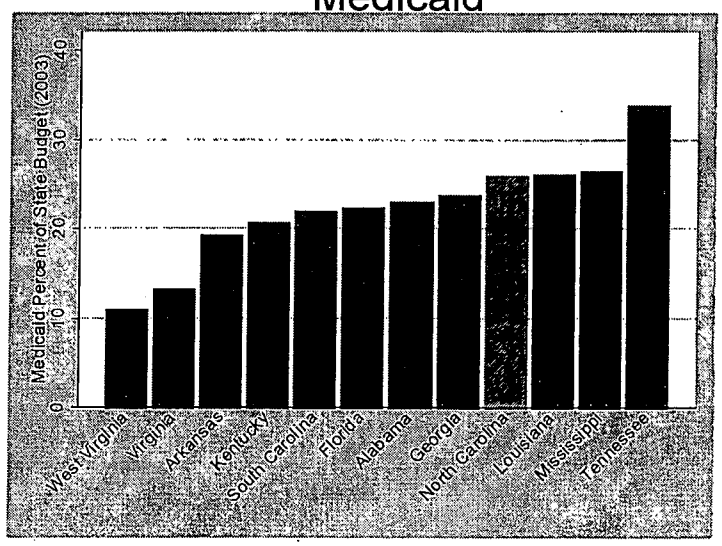
...and in percent of state budget

Medicaid



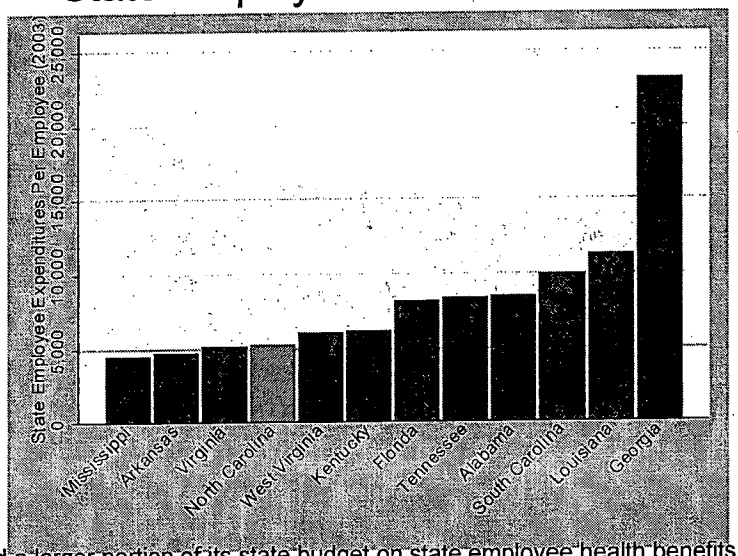
North Carolina spent more per capita on Medicaid than any state other than Tennessee.

Medicaid



In terms of percent of state budget, NC is in the upper third of Southeast states.

State Employees Health Benefits



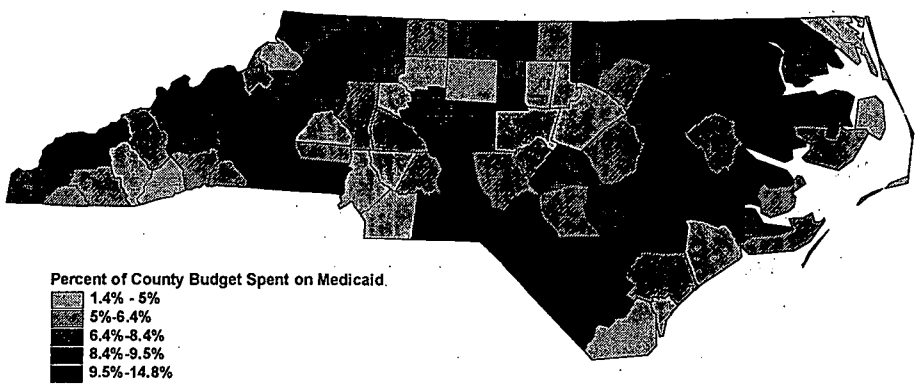
NC had a larger portion of its state budget on state employee health benefits than most other states, but a large cause of this may be the higher number of "state employees" in North Carolina.

State/County Partnerships

Medicaid

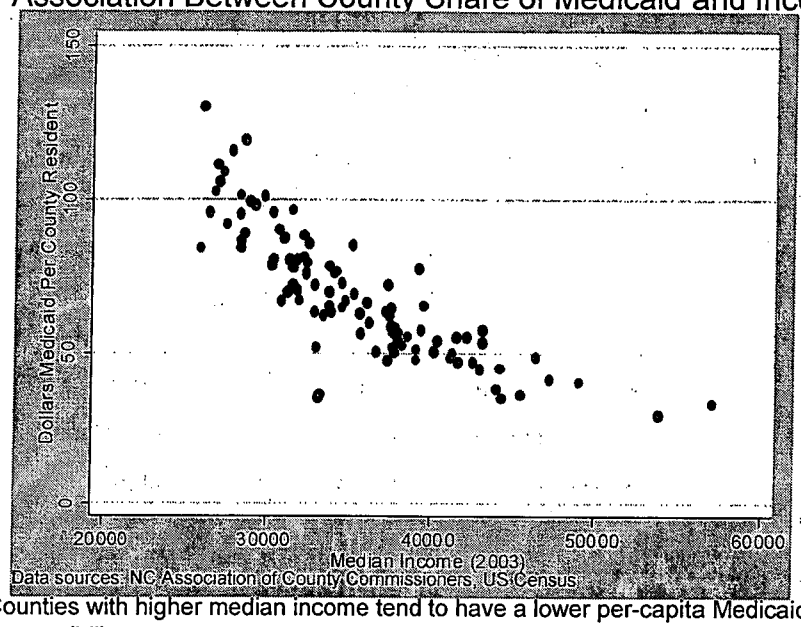
- North Carolina is one of two states in which counties have some liability for Medicaid expenditures.
  - New York and North Carolina both have instituted (limited) caps
- Of the total Medicaid expenditure, NC counties are responsible for approximately 5 percent (the exact percent varies by whether the expenditure is for *program* or for *administration;* 5 percent is the effective average)

Percent of County Budget Spent on Medicaid (SFY 2006)



Data Source: NC Association of County Commissioners

Association Between County Share of Medicaid and Income



Counties with higher median income tend to have a lower per-capita Medicaid responsibility.

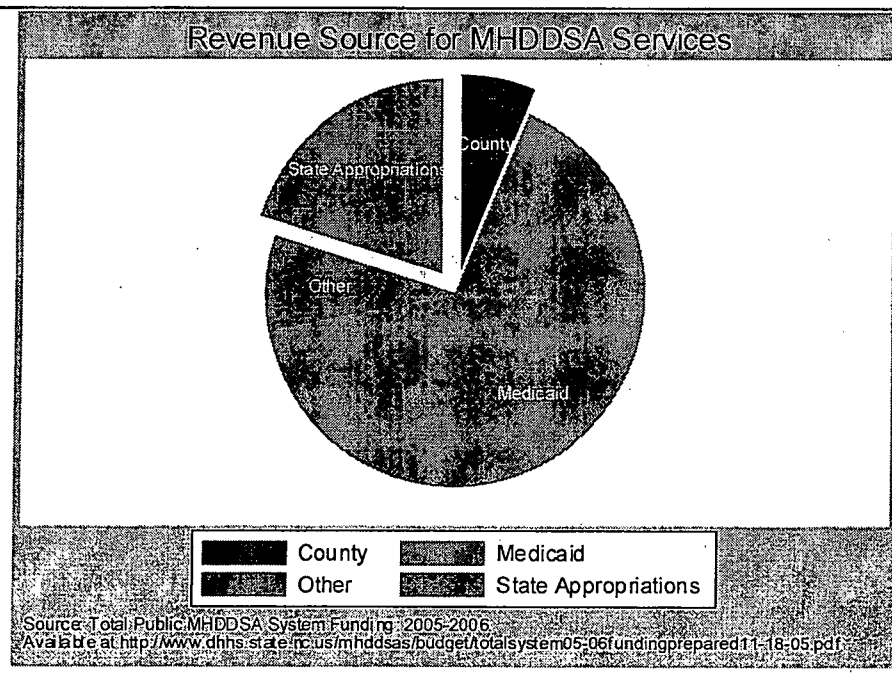
Caution: The "apples" problem

- The county contribution to Medicaid receives a fair amount of public attention and is relatively easy to understand
- Nationally, state and local governments have responsibilities for multiple healthcare services (e.g. indigent care, public health) and there are very little data allowing comparison of county and state contributions across the country.

Other county expenditures

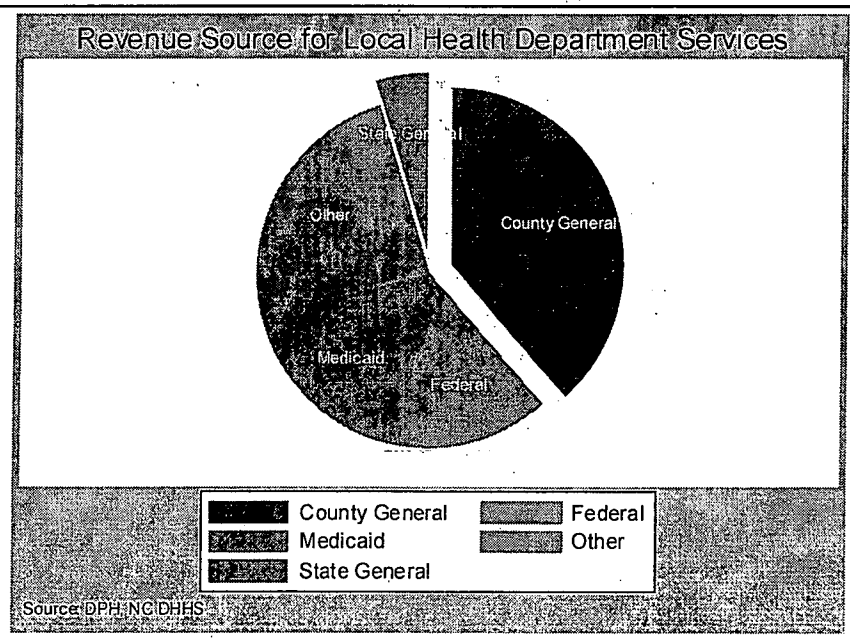
- Mental Health, Developmental Disabilities and Substance Abuse (MHDDSA)
  - $1.7b in community-based care in SFY 2006-ish[1]
  - County general fund financed 6.3 percent
    - County share of Medicaid adds another three percent
  - State general fund financed 20.2 percent
    - State share of Medicaid adds another 20 percent

(1) http://www.dhhs.state.nc.us/mhddsas/budget/totalsystem05-06fundingprepared11-18-05.pdf



Other county expenditures

- Local Health Departments
  - $516 million in 2005-2006
  - County general fund financed 38 percent
    - County share of Medicaid adds another one percent
  - State general fund financed 5 percent
    - State share of Medicaid adds another 5 percent



Conclusion

- Healthcare expenditures increasing
- State expenditures on the higher side relative to our neighbours
- County share for Medicaid unusual nationally
  - Higher burden on low income counties
- Counties and state also share some costs for other services, such as MHDDSA and Local Health Departments.
- Exercise caution in comparing state/county burden across states

Contact Information

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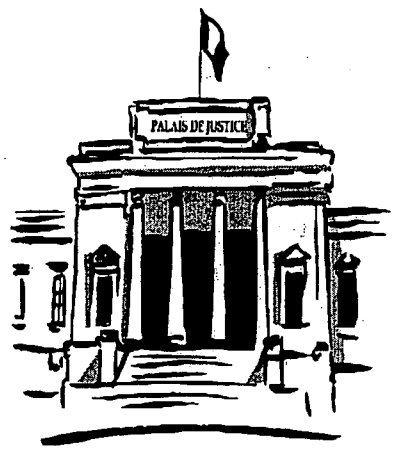
Financing Public Elementary & Secondary Education in North Carolina



State and Local Fiscal Modernization Committee
North Carolina General Assembly
A. John (Jack) Vogt
Alex L. Hess III
School of Government, UNC-CH

Overview
Financing N. C. Public Schools*

- **Importance & issues**
- **Shared responsibilities**
- **Key legal provisions**
- **Public school financing**
  - Overall public school financing: N. C. & selected states
  - Sources of financing: state, local (county), & federal
  - Per capita school spending for current expenses, capital outlay, & county debt service
- **Financing methods for public school construction**

*Public Elementary & Secondary Education

Importance and Issues Financing N. C. Public Schools

- Need to compete globally
- Disparities in student performance: individually, across counties, by race, etc.
- "Leandro"
- State growth requiring construction of many new schools and issuance of debt, e. g. Wake County $960 million bond authorization
- Recruiting & retaining teachers, e. g. Bill Gates--we must pay teachers more

Shared Responsibilities Financing N. C. Public Schools

- **Joint state-local responsibility**
  - State contributes about 65% of total funds, mainly for instruction & current expense
  - Counties provide about 30% (not counting school bond debt service) , mainly for buildings & plant.
  - Federal government contributes about 5%, more in lower income counties

- **At local level, school board and board of county commissioners** (both elected) **share responsibility**
  - School board sets local educational policy
  - County Commissioners fund local share of that policy
  - If school board & commissioners disagree, statutes provide for mediation. If that fails, court decides.

Key Legal Provisions Financing N. C. Public Schools

- **N. C. Constitution, Art. 9, Sec. 2:** "The General Assembly shall provide by taxation and otherwise for a general and uniform system of free public schools, which shall be maintained at least nine months in every year, and wherein equal opportunities shall be provided for all students
- **School Budget & Fiscal Control Act, Article 31, Chapter 115C of General Statutes**
  - G. S. 115C-426 Uniform Budget Format for school systems
  - G. S. 115C-429 "commissioners' action" on (school) budget
  - G. S. 115C-431 Resolving budget dispute between commissioners and board of education
- **Many other legal provisions**

Introduction: Public School Spending & Sources of Funding

- **Comparative benchmark states**
- **N. C. counties selected for comparative purposes**
- **Overall public school spending per capita**
- **Sources of funds for public schools**
- **Spending per capita for public school current expenses, capital outlay & county debt service**
- **Finance methods for school construction**

Comparing N. C. with Benchmark States

	Population	Rationale/Inclusion
California	34,526,660	Large, Growing
Florida	16,350,565	Southern, Growing
Georgia	8,415,600	Southern, Growing
Illinois	12,518,506	Midwestern, Large
Maryland	5,379,591	Mid-Atlantic
Minnesota	4,984,621	Progressive
New Jersey	8,504,864	Similar in size
North Carolina	8,198,279	
Texas	21,333,606	Large, Growing
Virginia	7,191,941	Mid-Atlantic

N. C. Counties Selected for comparative Purposes

Counties	2004 Pop	Rationale/Inclusion
Wake	719,520	Large, Rapid Growth, Wealthy
Forsyth	320,919	Large, Good Growth/Wealth
Buncombe	215,680	Medium-size, Mountain
Alamance	138,462	Medium-size, Piedmont
Catawba	149,466	Medium, Piedmont
Carteret	62,034	Medium-small, Coastal
Ashe	25,224	Small, Mountain
Montgomery	27,501	Small, Piedmont, Lower Income
Northampton	21,624	Small, East, Lower Income
Robeson	126,469	Medium, East, Lower Income

Overall Public School Spending: N. C. & Benchmark States

- N. C. spends less per capita* for public schools, relative to state personal income, than most other benchmark states (Slides 10, 11, and 12).

- N. C. spends less per capita for public schools, as % of state GDP, than any other benchmark state (Slides 13 and 14).

*Per state population

Public School Spending Per Capita N. C. & Benchmark States, 2001-02

New Jersey:	$2,074
Minnesota:	$1,694
Texas:	$1,667
Illinois:	$1,604
California:	$1,595
Maryland:	$1,558
Georgia:	$1,507
Virginia:	$1,401
North Carolina:	$1,205
Florida:	$1,165

U.S. Census Bureau

Per Capita State Personal Income N. C. & Benchmark States 2001

New Jersey:	$39,148
Maryland:	$35,627
California:	$32,882
Minnesota:	$32,616
Illinois:	$32,532
Virginia:	$32,505
Florida:	$29,273
Texas:	$29,045
Georgia:	$28,592
North Carolina	$27,493

Bureau of Economic Analysis

Per Capita Public School Spending As % of Per Capital Personal Income

Texas:	5.74%
New Jersey:	5.30%
Georgia:	5.27%
Minnesota:	5.19%
Illinois:	4.93%
California:	4.85%
North Carolina:	4.38% (7th)
Maryland:	4.37%
Virginia:	4.31%
Florida:	3.98%

*Spending for 2001-02 and income for 2001

U.S. Census Bureau, Bureau of Economic Analysis

State Gross Domestic Product Per Capita, N. C. & Benchmark States 2001

New Jersey:	$42,680
Virginia:	$38,482
Minnesota:	$38,164
Illinois:	$38,061
California:	$37,682
Maryland:	$35,813
Texas:	$35,730
Georgia:	$35,586
North Carolina	$34,843
Florida:	$30,422

U.S. Census Bureau, Bureau of Economic Analysis

Public School Spending As % of State GDP, N. C. & Benchmark States

New Jersey:	4.86%
Texas:	4.67%
Minnesota:	4.44%
Maryland:	4.35%
Georgia:	4.23%
California:	4.23%
Illinois:	4.22%
Florida:	3.83%
Virginia:	3.64%
North Carolina:	3.46%

*2001-02 spending and 2001 GDP

U.S. Census Bureau, Bureau of Economic Analysis

Sources of Funding: N. C. Benchmark States & Selected N. C. Counties

- State revenue sources account for a higher portion of public school funding in N. C. than in any other benchmark state (Slide 16). Local sources account for a lower portion of public school funding in N. C. than any benchmark state (Slide 17).
- State sources account for about 65%, County sources 25% & Federal sources 10% of Public school current expense funding (Slide 18).
- In N. C. county revenues have increased more than state revenues to finance public school per capita current expenses, 1994-95 to 2004-05 (Slide 18).
- County sources account for a relatively higher portion (around 30%) of public school current expense funding in larger, wealthier counties. Federal sources are more important in lower income counties (Slide 19).

% of Public School Revenues From State Sources (2001-02)

North Carolina:	66%
California:	65%
Minnesota:	64%
Georgia:	52%
Florida:	51%
Virginia:	44%
New Jersey:	44%
Texas:	43%
Illinois:	40%
Maryland:	40%

% of Public School Revenues From Local Sources (2001-02)

Maryland:	60%
Illinois:	60%
Texas:	57%
New Jersey:	56%
Virginia:	56%
Florida:	49%
Georgia:	48%
Minnesota:	36%
California:	35%
North Carolina:	34%

N. C. Per Capita Public School Current Expenses By Funding Source

Sources	1994-5	2004-5	% 04-05	% Chg 95-05
State:	$542	$737	65%	36 %
Local:	$181	$283	25%	56%
Federal:	$61	$123	10%	102%
Total:	$784	$1,143	100%	46%

U.S. Census Bureau, Public Schools of NC, Office of the State Superintendant

Public School Current Expense Funding By Source, Selected Counties, 2004-05

County	State %	Local %	Federal %
Wake	61 %	32 %	7 %
Forsyth	62 %	30 %	8 %
Buncombe	62 %	29 %	9 %
Alamance	66 %	24 %	10 %
Catawba	67 %	23 %	10 %
Carteret	60 %	31 %	9 %
Ashe	69 %	18 %	13 %
Montgomery	64 %	19 %	16 %
Northampton	67 %	16 %	18 %
Robeson	70 %	12 %	18 %

U.S. Census Bureau, Public Schools of NC, Office of the State Superintendant

Current Expense, Capital Outlay & County Debt Service Spending for Public Schools

- It is difficult to discern differences in per capita school current expense spending or changes in such spending among different size counties (Slide 21).
- Per capita county appropriations for school capital outlay has over time, reflecting varying needs from year to year (Slide 22).
- Per capita county spending for debt service, including school bonds, has grown greatly, reflecting state growth. Generally, debt service per capita has increased more in larger than smaller counties (Slide 23).

Per Capita Public School Current Expenses By County

County	1994-5	2004-5	$ Change	% Change
Wake	$729	$1,143	$414	57%
Forsyth	$743	$1,119	$376	51%
Buncombe	$790	$1,007	$217	27%
Alamance	$712	$1,032	$320	45%
Catawba	$781	$1,105	$324	41%
Carteret	$691	$1,062	$371	54%
Ashe	$762	$1,061	$299	39%
Montgomery	$852	$1,342	$490	58%
Northampton	$918	$1,329	$411	45%
Robeson	$973	$1,362	$389	40%

U.S. Census Bureau, Public Schools of NC, Office of the State Superintendant

Per Capita County Appropriation for School Capital Outlay

County	1994-95	2004-05
State-wide	$69	$105
Wake	$137	$196
Forsyth	$36	$146
Buncombe	$81	$57
Alamance	$71	$18
Catawba	$128	$167
Carteret	$78	$23
Ashe	$34	$26
Montgomery	$13	$25
Northampton	$30	$90
Robeson	$23	$41

NC Department of State Treasurer, State and Local Government Finance Division

Per Capita County Expenditures for Debt Service, Including school bonds

County	1994-95	2004-05	%Change
State-wide	$59	$113	92%
Wake	$69	$160	132%
Forsyth	$64	$116	81%
Buncombe	$97	$103	6%
Alamance	$30	$46	53%
Catawba	$44	$205	366%
Carteret	$61	$108	77%
Ashe	$32	$78	144%
Montgomery	$73	$62	–15%
Northampton	$63	$78	24%
Robeson	$45	$33	–27%

NC Department of State Treasurer, State and Local Government Finance Division

Financing Methods for Public School Construction

- **Mainly county responsibility:** Shows up in county appropriations for school capital outlay & in county debt service. County is responsible for repaying debt issued for local public school construction.
- **Sources of capital financing:**
  - County G. O. bonds, approved by voters
  - County certificates of participation (COPs)
  - State public school fund money
  - State lottery proceeds
  - Other: impact fees in Orange & Chatham counties, etc.

Public School System Finances - 2001-02 (dollar amounts are in thousands)													
		Elementary-secondary revenue											
Geographic Area	Population July 1, 2001	Total	From Federal Sources	Total From State & Local Sources	From State Sources	% From State Sources (Federal $ Excluded)	From Local Sources	% From Local Sources (Federal $ Excluded)	Elementary-secondary expenditure	Gross Domestic Product - 2001	Total Elementary-Secondary Revenue % of GDP	State & Local Revenue % of GDP	Elementary-Secondary Expenditure % of GDP
United States	285,107,923	419,797,506	32,703,469	387,094,037	207,374,637	53.57%	179,719,400	46.43%	435,314,714	10,058,168,000	4.17%	3.85%	4.33%
California	34,526,660	53,033,838	5,084,409	47,949,429	31,005,317	64.66%	16,944,112	35.34%	55,068,983	1,301,050,000	4.08%	3.69%	4.23%
Florida	16,350,565	18,538,739	1,762,460	16,776,279	8,542,871	50.92%	8,233,408	49.08%	19,051,049	497,423,000	3.73%	3.37%	3.83%
Georgia	8,415,600	13,038,876	904,826	12,134,050	6,361,710	52.43%	5,772,340	47.57%	12,676,587	299,442,000	4.35%	4.05%	4.23%
Illinois	12,518,506	18,562,363	1,438,287	17,124,076	6,808,150	39.76%	10,315,926	60.24%	20,084,491	476,461,000	3.90%	3.59%	4.22%
Maryland	5,379,591	8,424,902	527,311	7,897,591	3,133,775	39.68%	4,763,816	60.32%	8,381,273	192,659,000	4.37%	4.10%	4.35%
Minnesota	4,984,621	7,811,595	409,915	7,401,680	4,771,002	64.46%	2,630,678	35.54%	8,443,445	190,231,000	4.11%	3.89%	4.44%
New Hampshire	1,258,546	1,819,692	85,440	1,734,252	943,592	54.41%	790,660	45.59%	1,850,639	44,279,000	4.11%	3.92%	4.18%
New Jersey	8,504,864	17,470,524	720,470	16,750,054	7,336,383	43.80%	9,413,671	56.20%	17,642,412	362,987,000	4.81%	4.61%	4.86%
North Carolina	8,198,279	9,699,590	777,970	8,921,620	5,929,203	66.46%	2,992,417	33.54%	9,882,399	285,651,000	3.40%	3.12%	3.46%
Texas	21,333,606	32,674,518	2,941,562	29,732,956	12,930,564	43.49%	16,802,392	56.51%	35,565,417	762,247,000	4.29%	3.90%	4.67%
Virginia	7,191,941	9,761,048	624,507	9,136,541	4,002,347	43.81%	5,134,194	56.19%	10,074,886	276,762,000	3.53%	3.30%	3.64%

Population figures from U.S. Census Bureau - National and State Population Estimates - Annual Population Estimates 2000 to 2005 (Annual Estimates of the Population for the United States and States, and for Puerto Rico: April 1, 2000 to July 1, 2005) - http://www.census.gov/popest/states/NST-ann-est.html (Release Date: December 22, 2005).

Revenue and Expenditure figures from U.S. Census Bureau - Federal, State, and Local Governments - 2002 Census of Governments - Volume 4, No. 1, Public Education Finances – Table 1, Summary of Public School System Finances for Elementary-Secondary Education by State: 2001-02 - http://www.census.gov/prod/2004pubs/gc024x1.pdf (Issued September 2004).

Gross Domestic Product figures from Bureau of Economic Analysis - Regional Economic Accounts – Gross Domestic Product by State – Interactive Tables – All States and Regions – 2001 - http://www.bea.gov/bea/regional/gsp/ (Last revised: October 26, 2006).

Taxes & Personal Income (thousands of dollars)									
		General Revenue From Own Sources - State & Local - Taxes - 2001-02							
Geographic Area	**Population July 1, 2001**	Property	Sales and Gross Receipts	Individual Income	Other	Total Taxes		**Personal Income - 2001**	**Per Capita Personal Income - 2001 (dollars)**
United States	285,107,923	279,191,478	324,122,506	202,832,254	98,954,564	905,100,802		8,716,992,000	30,574
California	34,526,660	30,242,523	41,559,857	33,046,665	15,575,021	120,424,066		1,135,304,060	32,882
Florida	16,350,565	15,799,202	22,936,417	N/A	6,149,818	44,885,437		478,637,023	29,273
Georgia	8,415,600	6,640,041	9,395,052	6,487,638	1,535,649	24,058,380		240,616,123	28,592
Illinois	12,518,506	15,872,667	13,958,336	7,471,385	4,349,853	41,652,241		407,253,595	32,532
Maryland	5,379,591	5,412,209	4,973,619	7,644,183	1,844,270	19,874,281		191,656,697	35,627
Minnesota	4,984,621	5,214,735	5,917,693	5,443,355	1,880,626	18,456,409		162,577,516	32,616
New Hampshire	1,258,546	2,169,494	605,386	71,433	752,549	3,598,862		42,623,930	33,868
New Jersey	8,504,864	16,049,550	8,803,618	6,867,275	2,908,361	34,628,804		332,951,217	39,148
North Carolina	8,198,279	5,421,740	7,851,733	7,265,242	2,037,704	22,576,419		225,395,011	27,493
Texas	21,333,606	24,520,989	28,639,281	29	5,820,209	58,980,508		619,642,245	29,045
Virginia	7,191,941	6,710,588	6,542,184	6,710,995	2,167,479	22,131,246		233,770,486	32,505

Population figures from U.S. Census Bureau - National and State Population Estimates - Annual Population Estimates 2000 to 2005 (Annual Estimates of the Population for the United States and States, and for Puerto Rico: April 1, 2000 to July 1, 2005) - http://www.census.gov/popest/states/NST-ann-est.html (Release Date: December 22, 2005).

Taxation figures from U.S. Census Bureau - Federal, State, and Local Governments - State and Local Government Finances - 2002 Census of Governments - US Summary and Alabama through Mississippi & Missouri through Wyoming (State and Local Government Finances by Level of Government and by State: 2001 – 02) - http://www.census.gov/govs/www/estimate02.html (Last revised: October 14, 2004).

Income figures from Bureau of Economic Analysis - Regional Economic Accounts - Annual Personal Income - http://bea.gov/bea/regional/spi/default.cfm?satable=SA05N&series=NAICS (September 2006).

2004-05 Current Expense Expenditures by Source of Funds												
		Amounts Expended by Source										
Geographic Area	County/State Population - July 1, 2004	State	State Per Capita	Federal	Federal Per Capita	Local	Local Per Capita	Total	Total Per Capita	% State	% Federal	% Local
Alamance	138,462	93,558,857	676	14,600,488	105	34,695,277	251	142,854,622	1,032	65.5%	10.2%	24.3%
Ashe	25,224	18,549,991	735	3,527,324	140	4,682,835	186	26,760,150	1,061	69.3%	13.2%	17.5%
Buncombe		115,395,235		16,219,996		46,806,415		178,421,646		64.7%	9.1%	26.2%
Asheville		19,105,322		3,931,934		15,649,144		38,686,400		49.4%	10.1%	40.5%
Buncombe-Asheville	215,680	134,500,557	624	20,151,930	93	62,455,559	290	217,108,046	1,007	61.9%	9.3%	28.8%
Carteret	62,034	39,657,667	639	6,239,034	101	20,005,916	322	65,902,617	1,062	60.2%	9.4%	30.4%
Catawba		76,068,803		9,080,890		25,626,053		110,775,746		68.7%	8.2%	23.1%
Hickory		20,678,944		3,510,324		7,510,558		31,699,826		65.2%	11.1%	23.7%
Newton-Conover		13,898,435		3,302,856		5,538,789		22,740,080		61.1%	14.5%	24.4%
Catawba-Hickory-Newton-Conover	149,466	110,646,182	740	15,894,070	106	38,675,400	259	165,215,652	1,105	67.0%	9.6%	23.4%
Forsyth	320,919	220,861,325	688	29,407,403	92	108,813,113	339	359,081,841	1,119	61.5%	8.2%	30.3%
Montgomery	27,501	23,732,723	863	6,070,793	221	7,104,402	258	36,907,918	1,342	64.3%	16.4%	19.3%
Northampton	21,624	19,109,444	884	5,190,073	240	4,443,623	205	28,743,140	1,329	66.5%	18.0%	15.5%
Robeson	126,469	120,878,099	956	30,315,430	240	21,002,566	166	172,196,095	1,362	70.2%	17.6%	12.2%
Wake	719,520	500,847,014	696	57,777,761	80	263,442,090	366	822,066,865	1,143	60.9%	7.0%	32.1%
North Carolina	8,541,221	6,295,926,901	737	1,051,335,357	123	2,413,150,687	283	9,760,412,945	1,143	64.5%	10.8%	24.7%

1994-95 Current Expense Expenditures by Source of Funds												
		Amounts Expended by Source										
Geographic Area	County/State Population - July 1, 1994	State	State Per Capita	Federal	Federal Per Capita	Local	Local Per Capita	Total	Total Per Capita	% State	% Federal	% Local
Alamance		36,518,242		3,517,930		10,105,442		50,141,614		72.8%	7.0%	20.2%
Burlington		20,961,028		2,192,244		7,613,560		30,766,832		68.1%	7.1%	24.8%
Alamance-Burlington	113,571	57,479,270	506	5,710,174	50	17,719,002	156	80,908,446	712	71.0%	7.1%	21.9%
Ashe	23,108	13,240,899	573	1,589,000	69	2,772,270	120	17,602,169	762	75.2%	9.0%	15.8%
Buncombe		79,686,805		6,616,782		29,397,108		115,700,695		68.9%	5.7%	25.4%
Asheville		16,323,415		4,236,293		10,465,381		31,025,089		52.6%	13.7%	33.7%
Buncombe-Asheville	185,785	96,010,220	517	10,853,075	58	39,862,489	215	146,725,784	790	65.4%	7.4%	27.2%
Carteret	56,057	26,503,339		2,937,078	52	9,278,303	166	38,718,720	691	68.5%	7.5%	24.0%
Catawba		43,521,118		3,053,303		14,270,702		60,845,123		71.5%	5.0%	23.5%
Hickory		14,055,427		1,610,078		5,439,212		21,104,717		66.6%	7.6%	25.8%
Newton-Conover		10,438,949		949,636		3,739,718		15,128,303		69.0%	6.3%	24.7%
Catawba-Hickory-Newton-Conover	124,280	68,015,494	547	5,613,017	45	23,449,632	189	97,078,143	781	70.1%	5.8%	24.2%
Forsyth	277,804	126,547,465	456	10,849,026	39	69,024,891	248	206,421,382	743	61.3%	5.3%	33.4%
Montgomery	23,485	14,868,093	633	2,129,422	91	3,011,944	128	20,009,459	852	74.3%	10.6%	15.1%
Northampton	20,882	13,910,743	666	2,657,509	127	2,595,869	124	19,164,121	918	72.6%	13.8%	13.6%
Robeson	110,439	77,986,905	706	14,836,073	134	14,586,860	132	107,409,838	973	72.6%	13.8%	13.6%
Wake	494,366	239,214,943	484	17,021,563	34	103,957,412	210	360,193,918	729	66.4%	4.7%	28.9%
North Carolina	7,060,959	3,824,151,607	542	432,585,497	61	1,277,834,616	181	5,534,571,720	784	69.1%	7.8%	23.1%

Population figures from U.S. Census Bureau - Population Estimates - Archives - 2000's, 1990,s - http://www.census.gov/popest/archives/ - Annual Estimates of the Population for Counties of North Carolina: April 1, 2000 to July 1, 2004 (Release Date: April 14, 2005); County Population Estimates and Demographic Components of Population Change: Annual Time Series, July 1, 1990 to July 1, 1999 (Internet Release Date: March 9, 2000)

Expenditure figures from Statistical Profile of North Carolina Schools - 2006 edition (for 2004-05 figures) online at http://www.ncpublicschools.org/fbs/resources/data/ - 1994-95 figures from 1996 edition.

Expenditures for Education - Selected N.C. Counties - 2004-05							
		Expenditures for Education - 2004-05					
Geographic Area	**Population - July 1, 2004**	Education - Public School Current Expenditures	Education - Public School Current Expenditures Per Capita	Education - Public School Capital Outlay	Education - Public School Capital Outlay Per Capita	**Total Expenditures - 2004-05**	**Education - Public School Current Expenditures as % of Total Expenditures**
Alamance	137,126	25,121,359	183	2,450,860	18	119,563,609	21.01%
Ashe	25,104	2,967,876	118	656,584	26	24,213,216	12.26%
Buncombe	215,112	41,366,605	192	12,249,377	57	263,537,920	15.70%
Carteret	61,870	16,956,993	274	1,432,104	23	73,902,703	22.95%
Catawba	147,789	27,192,375	184	24,663,035	167	204,613,168	13.29%
Forsyth	320,764	87,747,516	274	46,899,560	146	376,708,590	23.29%
Montgomery	27,153	5,043,009	186	678,280	25	27,980,897	18.02%
Northampton	21,566	3,180,500	147	1,932,872	90	30,409,278	10.46%
Robeson	126,554	12,089,012	96	5,152,231	41	119,463,866	10.12%
Wake	723,708	233,570,793	323	141,994,818	196	995,310,056	23.47%
North Carolina	8,541,263	1,895,217,052	222	893,993,802	105	10,827,933,126	17.50%

Expenditures for Education - Selected N.C. Counties - 1994-95							
		Expenditures for Education - 1994-95					
Geographic Area	**Population - July 1, 1994**	Education - Public School Current Expenditures	Education - Public School Current Expenditures Per Capita	Education - Public School Capital Outlay	Education - Public School Capital Outlay Per Capita	**Total Expenditures - 2004-05**	**Education - Public School Current Expenditures as % of Total Expenditures**
Alamance	113,670	13,357,104	118	8,115,523	71	64,772,595	20.62%
Ashe	22,924	1,880,000	82	777,607	34	10,852,599	17.32%
Buncombe	185,810	26,997,753	145	15,059,144	81	156,008,944	17.31%
Carteret	56,624	7,326,291	129	4,395,442	78	41,753,631	17.55%
Catawba	123,913	17,920,468	145	15,859,617	128	103,411,426	17.33%
Forsyth	276,172	60,723,675	220	10,060,357	36	216,213,671	28.09%
Montgomery	23,684	2,155,710	91	302,028	13	14,579,671	14.79%
Northampton	20,611	2,264,577	110	616,423	30	17,430,279	12.99%
Robeson	109,876	10,434,060	95	2,516,848	23	67,335,501	15.50%
Wake	496,578	95,019,404	191	68,058,312	137	449,843,012	21.12%
North Carolina	7,121,975	1,016,492,300	143	491,513,100	69	5,598,151,900	18.16%

2004-05 figures from North Carolina Dept. of State Treasurer - State & Local Government Finance Division - North Carolina County and Municipal Financial Information – Counties - http://www.nctreasurer.com/lgc/units/unitlistjs.htm (Last updated 11/8/06). 1994-05 figures from Fiscal Summary of North Carolina Counties for the Fiscal Year ended June 30, 1995 (Prepared by the North Carolina Association of County Commissioners and the North Carolina Department of the State Treasurer).

Expenditures for Debt Service - Selected N.C. Counties - 2004-05 and 1994-95						
		2004-05			1994-95	
Geographic Area	**Population - July 1, 2004**	Expenditures for Debt Service	Expenditures for Debt Service Per Capita	**Population - July 1, 1994**	Expenditures for Debt Service	Expenditures for Debt Service Per Capita
Alamance	137,126	6,281,281	46	113,670	3,397,611	30
Ashe	25,104	1,969,358	78	22,924	740,108	32
Buncombe	215,112	22,183,500	103	185,810	18,036,944	97
Carteret	61,870	6,709,003	108	56,624	3,431,638	61
Catawba	147,789	30,337,372	205	123,913	5,396,101	44
Forsyth	320,764	37,166,967	116	276,172	17,806,992	64
Montgomery	27,153	1,673,455	62	23,684	1,733,261	73
Northampton	21,566	1,677,313	78	20,611	1,289,688	63
Robeson	126,554	4,223,673	33	109,876	4,894,707	45
Wake	723,708	115,866,734	160	496,578	34,157,256	69
North Carolina	8,541,263	961,541,500	113	7,121,975	418,019,400	59

2004-05 figures from North Carolina Dept. of State Treasurer - State & Local Government Finance Division - North Carolina County and Municipal Financial Information – Counties - http://www.nctreasurer.com/lgc/units/unitlistjs.htm (Last updated 11/8/06). 1994-05 figures from Fiscal Summary of North Carolina Counties for the Fiscal Year ended June 30, 1995 (Prepared by the North Carolina Association of County Commissioners and the North Carolina Department of the State Treasurer).

State and County Funding for Education								
1994-95								
State			Counties					
General Fund for Public Education	Grand Total from General Fund	General Fund for Public Education as % of Grand Total from General Fund	County School Current Expense and School Capital Outlay	Total County Expenditures	County School Current Expense and School Capital Outlay as % of Total County Expenditures	County Debt Service (Total)	Total County Expenditures	County Debt Service (Total) as % of Total County Expenditures
3,686,213,058	10,208,424,627	36.11%	1,508,005,400	5,598,151,900	26.94%	418,019,400	5,598,151,900	7.47%
2004-05								
State			Counties					
General Fund for Public Schools	Total General Fund	General Fund for Public Schools as % of Total General Fund	County School Current Expense and School Capital Outlay	Total County Expenditures	County School Current Expense and School Capital Outlay as % of Total County Expenditures	County Debt Service (Total)	Total County Expenditures	County Debt Service (Total) as % of Total County Expenditures
6,157,264,907	15,918,359,528	38.68%	2,789,210,854	10,827,933,100	25.76%	961,541,500	10,827,933,100	8.88%

Figures for the state from Overview: Fiscal and Budgetary Actions North Carolina General Assembly, 2004 Session and 1993 and 1994 Sessions, prepared by the Fiscal Research Division of the North Carolina General Assembly. 2004-05 figures for counties from North Carolina Dept. of State Treasurer - State & Local Government Finance Division - North Carolina County and Municipal Financial Information – Counties - http://www.nctreasurer.com/lgc/units/unitlistjs.htm (Last updated 11/8/06). 1994-05 figures for counties from Fiscal Summary of North Carolina Counties for the Fiscal Year ended June 30, 1995, prepared by the North Carolina Association of County Commissioners and the North Carolina Department of the State Treasurer.-

Infrastructure—Transportation, Water & Sewer and Local Government Borrowing Authority
Fiscal Modernization Study Commission Presentation
David M. Lawrence and Kara A. Millonzi, UNC School of Government
November 29, 2006

I. Transportation Infrastructure

Responsibility for Streets and Highways

North Carolina is almost unique among the 50 states in that its county governments have no construction or maintenance responsibility for streets or highways. This has been the case since 1931, when the state assumed responsibility for the road systems then maintained by the counties. As a result the N.C. Department of Transportation (DOT) is responsible for the entire public road and highway system outside of cities and towns. What would be county roads in other states are part of North Carolina's secondary road system.

Inside cities, DOT shares responsibility with the various cities and towns. The state is responsible for those major roads that move traffic through a city or town or move traffic to major destinations within a city or town. All other public streets or roads within a city or town are that local government's responsibility. (Cities can also participate to a limited extent in construction of state roads within and nearby their borders.)

The Extent of the Public Road System

According to DOT's publication, 2005 Highway and Road Mileage, here is the extent of North Carolina's public road system as of 31 December 2005:

DOT-maintained

Primary Highway System	14,805 miles
Secondary Road System	64,204
Total DOT-maintained system	79,009 miles

City-maintained

City/town maintained	20,125.7 miles

(About 7800 miles of the DOT-maintained system is within cities and towns; the rest is in unincorporated areas. There are also a few hundred miles operated by State Parks and Wildlife and a little over 3,000 miles maintained by the federal government within federal lands and facilities.)

In 2001 DOT issued a report about highway needs over the next 25 years. It forecast $55 billion of expected resources during that period and $84 billion in anticipated needs. This gap of almost $30 billion is currently expected to grow larger.

Financing Streets and Highways

State Funding Structure

The State funds DOT programs through two major budgetary funds, the Highway Fund and the Highway Trust Fund.

The **Highway Fund** is the traditional budgeting and accounting entity for DOT programs, and it includes DOT programs beyond the Division of Highways, such as DMV, the Ferry division, and so on. It is also a major funding source for secondary road paving.

The **Highway Trust Fund** was created in 1989 with two principal purposes: to fund the so-called Intrastate highway system, which was intended to bring a 3600-mile system of 4-lane highways to all parts of the state; and to fund seven urban loops around the state's largest cities. A small portion of the Fund also supports paving of secondary roads. In addition, the Fund is required to transfer a substantial sum each year to the state's General Fund; this amount was originally $170 million annually, but in recent years it has been between $240 and $250 million. For the current year, however, the amount was reduced to $55 million.

In the last five years, the General Assembly has directed that substantial sums in the Highway Trust Fund be used for purposes other than those originally intended. SB 1005 of the 2001 session provided for the transfer of $687 million over three years for other DOT purposes, primarily pavement preservation ($470 million) and non-Highway activities such as transit ($120 million). The 2003 Moving Ahead initiative directed that another $700 million in cash balances be transferred over two years, with $630 million going to maintenance and modernization and the remainder for transit and other non-highway programs.

Over time the Intrastate system and urban loop systems have been expanded, particularly the latter. According to the 2005 report of the Highway Trust Fund Study Committee, the Intrastate system has grown from 3600 miles to 3633, and the urban loops have been expanded from 211 miles to 379. At the time the report was written, there remained 962 miles of the Intrastate system to complete and 265 miles of the urban loops.

State Funding Sources

Motor Fuels Tax. This tax is 17.5 cents per gallon plus the greater of 3.5 cents per gallon or 7 percent of the average wholesale price; the variable amount is adjusted every six months. The 2006 General Assembly capped the variable amount of the tax at 12.4 cents per gallon, through July 1, 2007, and the current total rate is 29.9 cents per gallon.

Highway Use Tax. This is a 3 percent tax, up to $1000, imposed when a new title is issued for a motor vehicle.

Federal funds.

The Highway Fund and Highway Trust Fund had these amounts of major revenues for the fiscal year that ended 30 June 2005. The amounts are in thousands:

Revenue source	Highway Fund	Highway Trust Fund
Motor fuels tax	972,559	324,269
Highway use tax		580,118
Federal funds	1,134,639	
Fees, licenses, fines	459,447	99,207
TOTALS	2,662,801	1,019,809
Expenditure totals	2,528,274	1,053,097

City Funding Sources

State street assistance (Powell Bill) is a program by which some state funding sources are shared with cities and towns. The city/town share is an amount equal to 1.75 cents per gallon of the motor fuels tax plus 6.5 percent of the net proceeds of the Highway Trust Fund. Three-quarters of the money is distributed to cities based on their population, and one-quarter on the basis of their miles of city-maintained streets. In 2005, these amounts were $23.03 per capita and $1709.23 per mile. This money is earmarked for street and sidewalk expenditures.

According to the reports received by the Local Government Commission, in 2004-05 cities collectively received $130,699,554 in Powell Bill funds. During the same year, they reported spending $405,242,182 on city streets and highways.

State Borrowing

The 1996 General Assembly authorized $ 950 million of state general obligation bonds for highway purposes, which were approved by the voters. The enabling legislation called for $500 million of the proceeds to be used for urban loops, $300 million for the Intrastate system, and $150 million for paving secondary roads. The last series of this authorization was issued in 2004, and the last $700 million provided the cash to fund the 2003 Moving Ahead initiative. Although the bonds are secured by the state's entire taxing power, the intention and practice has been to pay debt service from the Highway Trust Fund.

Effective in 2006 DOT may issue so-called GARVEE bonds, which are debt instruments issued in anticipation of the receipt of federal-aid highway funds, and which are payable solely from those funds when received. The proceeds must be used for federal-aided projects. This authorization could currently permit DOT to borrow about $950 million.

Toll Roads

In 2002 the General Assembly created the N.C. Turnpike Authority and authorized it to study and eventually operate up to nine toll projects, both highways and bridges. The Authority is currently in the study stage.

II. Water and Sewer Infrastructure[1]

Public Water and Sewer Systems

North Carolina has 535 public water systems and 409 public sewer systems statewide. Public water systems provide water to approximately 67 percent of the state's population and dispense more than 244.5 billion gallons of water a year. Public sewer systems serve roughly 51% of the population and treat more than 255 billion gallons of wastewater each year. Although there has been some movement towards regionalization, small water and sewer systems continue to dominate. For example, about half of North Carolina's water systems serve fewer than 2,500 people and 70 percent service fewer than 5,000 people. Small systems comprise 54 percent of sewer systems.

Local governments have a variety of alternatives for structuring public water and sewer systems.[2] Municipalities own and operate the vast majority of both water and sewer systems as public enterprises (G.S. 160A, Art. 16)—71 percent of the state's public water systems and 86 percent of the public sewer systems. Counties also are authorized to own and operate water and sewer systems as public enterprises (G.S. 153A, Art. 15).

A handful of other organizational structures have been created over the years because of local needs that could not be met by cities and counties acting alone. Counties can establish water and sewer districts when services are needed in a portion of the counties only (G.S. 162A, Art. 6). Any two or more political subdivisions (such as municipalities, sanitary, water and sewer districts or other special purpose districts) in a county or a political subdivision and any unincorporated areas, can petition the board of commissioners to create metropolitan water or sewer districts (G.S. 162A, Arts 4 & 5).

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[1] Most of the information on state and federal capital funding sources and levels of funding was obtained from The N.C. Rural Economic Development Center (The Rural Center). Based on research conducted through its Water2030 Initiative, the Rural Center published three reports on its findings—*Impact of the 1998 Clean Water Bonds*, *Trends in Water and Sewer Financing*, and *Water, Sewer and Stormwater Capital Needs*. The reports are available at http://www.ncruralcenter.org/water2030/index.html. Additional sources include The North Carolina State Water Infrastructure Commission, *Report and Recommendation to Governor Michael F. Easley and Members of the General Assembly of North Carolina* (November 1, 2006), The Drinking Water State Revolving Fund (DWSRF) Annual Report, Capitalization Grants For Period Ending June 30, 2006 (Sept. 30, 2006), available at http://www.deh.enr.state.nc.us/pws/srf/pdf/2006AnnualReport.pdf, The North Carolina Clean Water Management Trust Fund Annual Report 2005, available at http://www.cwmtf.net/ar2005.pdf, and the staff of the Environmental Finance Center, UNC School of Government.

[2] In addition to publicly owned and operated utilities, municipalities can grant franchises to privately owned public utility corporations to provide water and sewer services (N.C. Gen. Stat. § 160A-319 (2005) [hereinafter G.S.]). Public utility corporations also can petition the Public Utilities Commission to provide services in a designated area (G.S. 62, Art. 6).

The Commission for Health Services can create sanitary districts, after a petition process that starts with petitions from a majority of owners of real property in a proposed district, to operate water and sewer systems for the purpose of preserving and promoting public health and welfare (G.S. 130A, Art. 2, Pt. 2). A county, or two or more political subdivisions (such as municipalities or sanitary districts) can organize a water and sewer authority to provide water and sewer services (G.S. 162A, Art.1). Finally, municipalities and counties can define special service districts within their borders and levy additional taxes in those areas to provide sewer services and facilities that are not offered throughout the unit or that are offered at a lower level in the rest of the unit (G.S. 160A, Art. 23; G.S. 153A, Art. 16). Counties also can establish the districts for water services.

Together the county public enterprise systems and various districts comprise approximately 20 percent of the water systems and 13 percent of the sewer systems. Authorities account for only 1 percent of both public water and sewer systems.

Current Capital Financing Options for Water and Sewer Infrastructure

Federal and State Revenue Sources

Several federal agencies and commissions, including the U.S. Environmental Protection Agency (EPA), the U.S. Department of Agriculture (USDA), the U.S. Department of Housing and Urban Development (HUD), the U.S. Department of Commerce and the Appalachian Regional Commission, distribute funds directly to local communities for water and sewer capital projects. Other federal funds are funneled through various state agencies and often require the state to provide a certain percentage of matching funds.

The state also provides funding through appropriations to various state agencies and local communities. The most significant source of state funding over the past several years, however, was $800 million generated by the 1998 Clean Water Bonds. In anticipation of severe shortfalls in funds to pay for required water and sewer infrastructure projects, the General Assembly passed the Clean Water and Natural Gas Critical Needs Bond Act of 1998. North Carolina voters subsequently approved issuance of the Clean Water Bonds. They were designed to address the most urgent needs of the state's water and sewer systems by serving utilities unable to obtain other financing. The bond proceeds were distributed to three agencies and supported 1,103 projects in 97 counties. Rural, economically distressed areas benefited from three-quarters of the projects. They accounted for 30 percent of all water and sewer investments in North Carolina by state and federal sources from 1995-2005. With the exception of moneys earmarked for a few delayed construction projects, the proceeds of the Clean Water Bonds were depleted in fiscal year 2005-2006.

Local Revenue Sources

Loans from banks and other private lending institutions to local communities (debt financing) actually provide the largest source of funding for water and sewer capital

projects. These loans take several forms, including general obligation bonds, revenue bonds, special obligation bonds, tax increment bonds and installment, or lease-purchase, debt. Approximately 60 percent of North Carolina local governments cannot qualify for most private loan programs (bond market) because they are not considered credit-worthy, however. For these communities, state and federal contributions provide the main source of funding. In addition to debt financing, local governments and other public entities responsible for providing water and sewer services are authorized to raise funds through a variety of mechanisms, including property taxes and other unearmarked general fund revenue, impact fees, connection fees and special assessments.

The combined investments of federal and state funding and local borrowing provided an average of $789.5 million per year to local communities from 1995-2005. The following chart details the total amounts (in millions) awarded to North Carolina communities by each of the major funding sources from 1995-2005.[3] (It does not include amounts raised locally through property taxes or utility fees.)

Source	FY95	FY96	FY97	FY98	FY99	FY00	FY01	FY02	FY03	FY04	FY05	Totals
Federal Direct Funds	$76.4	$47.1	$56.5	$90.6	$75.0	$75.9	$85.9	$75.9	$70.6	$102.8	$58.8	**$815.7**
Clean Water Bonds	$30.8	$41.7	$3.1	$2.7	$111.2	$160.5	$146.9	$129.4	$76.1	$70.3	$36.1	**$808.9**
Federal Funds Administered by the State	$57.7	$50.5	$36.7	$46.5	$113.6	$127.3	$40.0	$49.8	$112.3	$70.5	$131.4	**$836.4**
All Other State Funds	$14.8	$6.0	$16.3	$28.9	$50.8	$23.6	$17.8	$16.9	$15.1	$14.4	$28.8	**$233.3**
Local/Public/ Private Market Loans	$175.3	$468.6	$234.6	$406.7	$744.1	$358.9	$733.5	$507.1	$837.2	$704.2	$816.4	**$5,986.6**
Totals	**$355.0**	**$613.8**	**$347.2**	**$575.3**	**$1,094.7**	**$746.3**	**$1,024.2**	**$779.1**	**$1,111.4**	**$962.2**	**$1,071.6**	**$8,681.0**

Complete figures for local funding sources, other than debt financing, for the period 1995-2005 are not readily available. As a rough estimate, according to the North Carolina Local Government Commission's Annual Financial Information Reports municipalities and counties spent roughly $9.6 billion on water and sewer construction, land acquisition, equipment, repairs to existing structures and the principal and interest payments for debt service on water and sewer bonds during the eleven-year period. Based on the figures for federal, state funding and local debt, North Carolina cities and counties received roughly $930 million from other sources, including local revenue-raising mechanisms.

[3] The figures were obtained from The Rural Center's Water 2030 Report 1, *Impact of 1998 Clean Water Bonds*, available at http://www.ncruralcenter.org/pubs/impactofbonds.pdf.

Future Water and Sewer Capital Financing Needs

According to the Rural Center, water use from public water systems will increase at a rate of 2.7 percent annually; sewer system use will increase at a rate of 2.9 percent annually. At this rate, the state's water and sewer systems will serve more than 9.8 million people by 2030—70 percent more than today. Based on these projections, North Carolina's public water, sewer (and stormwater) utilities will require investments totaling $16.63 billion to keep pace with necessary improvements and population growth over the next twenty-five years. The utilities will require $6.85 billion (an average of $1.37 billion per year) within the next five years to fund critical infrastructure needs.

The following chart details the capital needs projections for water, sewer and stormwater infrastructure through 2030.[4]

	2005-2010 (in billions)	2011-2030 (in billions)	Total (in billions)
Water	$ 2.84	$ 4.80	$ 7.64
Sewer	$ 3.44	$ 4.08	$ 7.52
Stormwater	$ 0.57	$ 0.90	$ 1.47
Total	**$ 6.85**	**$ 9.78**	**$ 16.63**

III. Local Government Borrowing Authority

There are five possible kinds of security that a local government may offer its lenders, and the differences in security affect the structure of the transaction, whether voter-approval is required, whether state approval will be needed, whether a bond attorney will be needed, and how the debt instruments will be sold.

General obligation borrowing

1. G.O. bonds are secured by the government's taxing power.

2. The government's taxing power is the strongest security, and therefore the G.O. borrowing rate will normally be the lowest rate available to the government.

3. G.O. borrowing almost always requires voter approval. The principle exceptions are for refunding bonds and for bonds within the two-thirds limitation.

4. G.O. borrowing must always be approved by the Local Government Commission.

5. A bond attorney is required for G.O. borrowing, and the bonds are always sold competitively through a public sale.

[4] The figures were obtained from The Rural Center's Water 2030 Report 3, *Water, Sewer & Stormwater Capital Needs*, available at http://www.ncruralcenter.org/pubs/capitalneeds.pdf.

6. G.O. borrowing is available for any capital purpose.

Installment financings

1. Installment financings are secured by the project financed with borrowed funds.

2. These financings are often referred to as "leases," "lease-purchases," "capital leases," or "160A-20s".

3. This form of financing is legally available for any capital purpose, but the more "essential" the project, the easier it is to find lenders for this form of security.

4. Voter approval is never required for installment financings.

5. The Local Government Commission must approve many but not all installment financings.

6. A bond attorney is frequently not necessary, if the financing is "bank-eligible". If it is bank-eligible, the financing will be placed with a bank. If the financing is publicly sold, it is done so through the issuance of certificates of participation, or COPs.

Revenue bond borrowing

1. Revenue bonds are secured by the revenues generated by the bond-financed project or by the system of which it is a part.

2. As a practical matter debt service coverage must be at least 150% in order to have a marketable deal. Therefore, the main purposes for which this form of financing is used are utilities, hospitals, and occasionally airports or parking structures.

3. Voter approval is never required for revenue bonds.

4. Revenue bonds must always be approved by the Local Government Commission.
5. A bond attorney is required for revenue bond financing. The bonds are sold through a negotiated sale, and they are sometimes placed with one or more banks.

Special obligation borrowing

1. S.O. bonds are secured by any revenue that is not produced by the government's taxing power.

2. S.O. bonds may only be issued to fund solid waste projects, water projects, sewer projects, and projects within municipal service districts.

3. Voter approval is never needed for S.O. bonds.

4. S.O. borrowing must always be approved by the Local Government Commission.

5. A bond attorney is required for S.O. borrowing. The bonds are sold through a negotiated sale, and they are frequently placed with one or more banks.

Project development (Tax increment) borrowing

1. Project development debt instruments are secured by taxes on new development generated after and because of the debt-financed project. They might also be secured by valuation agreements with landowners and by special obligation revenues.

2. Voter approval is never needed for project development debt.

3. Project development borrowing must always be approved by the Local Government Commission.

4. A bond attorney is required for project development financing. The debt instruments are sold through a negotiated sale, and they may often be placed with one or more banks or, if large, one or more mutual funds.

Courts and Corrections Financing Issues

James Drennan
School of Government, UNC
November, 2006
Fiscal Modernization Study Commission

Principles of Court Organization in NC

- Court reform in 1955-70
- Uniformity—of powers, of compensation, of method of selection, of procedures
- Unification of courts into single court
- State-funded in operations
- Elections as primary means of staffing

Courts

- State—operational costs
  - Personnel
  - Information technology
  - General operating costs
- Local—facilities and security
  - Courthouses and related offices
  - Security equipment and personnel

Court Financing Issues

- Who pays for
  - Courthouses
  - Computers
  - People
- Role of appropriations and fees in funding court operations

Corrections

- State role in Corrections since 1930's
- Current state/local roles:
  - Confinement
    - State–prisons for felons and some misdemeanants
    - County–pretrial detainees and misdemeanants
  - Community punishment
    - State—probation and parole
    - County—CJ Partnership, pretrial release, etc.

Issues in Corrections

- Capacity issues at both state and local level
- Effects of state courts on local jail needs
- Financing issues for jails
- Responsibility for safety in jails

Selected Issues in State/Local Funding of Courts and Corrections

Fiscal Modernization Study Commission

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November 2006

North Carolina Courts

North Carolina's current court system is the result of a sustained court reform effort that began in the mid-1950's and ended in 1970 with the last phase-in of the district court system. The following principles were used to shape that system:

1. Uniformity (salaries, procedures, powers of officials, costs, jurisdiction, etc.)
2. Unification of all local courts into a single General Court of Justice
3. State funding of personnel, equipment and operations and local funding of facilities
4. Elections as primary method to determine leaders

The goal of "uniformity" has an impact on the allocation of financial responsibility to state and local governments to pay for the court system. Providing operational resources from a central state source (the Administrative Office of the Courts) was a principal means of maintaining the uniformity that was a driving force in the court reform movement. Recent pressures to depart from that central state funding model have led to the use of local funds in various aspects of the court's operations, including providing computer equipment and personnel. To a lesser extent, the state has funded local courthouse construction or maintenance, which had previously been a local responsibility. The first may reflect a new understanding of the definition of a "uniform" court system, and both may reflect a blurring of the lines between the state and local government's roles in financing the courts.

NC Constitution, Art. IV, Sec. 20; GS 7A-300. (State pays operating costs)
GS 7A-302 (Local government—primarily county—provides facilities)

Issues in State-Local Responsibility to fund the courts

1. Facilities issues—strain on local tax base to fund capital costs; inequity/inadequacy in facilities; state financing of selected facilities; facilities for multi-county districts; costs for security; effects on local budgets by state budget decisions and schedules
2. Computer issues—funding for modernization; interfaces with local justice systems (police/jails)

3. Locally-paid court personnel—equity among rich/poor counties; permanence of funding; local specialty courts; impact on state funding
4. Court costs and fees—uniformity; adequacy to support local activities; control over use of money; role in financing programs

Allocation of Financial Responsibility for the Court System

All operating expenses of the Judicial Department are borne by the state (G.S. Ch. 7A, Subchapter VI). These include salaries and travel expenses of all judges, district attorneys, clerks and their assistants, magistrates, court reporters, public defenders, and guardians *ad litem*. Also included are the books, supplies, records, and equipment in all these officials' offices, and the fees of all jurors and witnesses for whom the government is responsible. This is a direct result of court reform efforts in the 1950s and 1960s. Before court reform, salaries and other operating expenses for most trial court officials (clerks, lower court judges, justices of the peace, and so forth) were the responsibility of local governments. Correspondingly, most fees collected went to local governments or directly to court officials as their compensation. The current arrangement reflects the fundamental policy decisions made during this court reform effort that all court officials should have the same duties and be paid the same salaries. As a result, citizens should receive roughly the same services from the courts wherever they live. That rigid commitment to uniformity, reflected in an original policy of requiring all operational funding to come from the state, has, since the late 1990s, begun to erode a bit. Acting on the request of local court and local government officials, the legislature authorized local governments to supplement the operations of the courts serving their counties or cities, and in some instances they have chosen to do so by funding temporary positions in the district attorney's, public defender's, or clerk's offices. But that is still the exception.

In the court reform effort of the 1960s, the primary responsibilities counties (and a few cities) retained for court operations was to provide "adequate" physical facilities for the courts. That duty has not changed since court reform. The most obvious of such facilities are courtrooms, but this duty also extends to the need for office and storage facilities, parking, and related spaces for judges, the clerk of superior court and the clerk's staff, district attorneys, and magistrates. In addition, most of the ancillary personnel listed in this chapter are entitled to county office space, either by specific statute or because they are part of the court system. The obligation to provide facilities includes the responsibility for furniture (but not equipment) and the cleaning and maintenance of the courthouse.

Questions often arise about whether particular expenses should be covered by the county or by the state. Often the issue is whether a particular item is an operating expense or part of a facility. What is the cable to connect the state's mainframe computer to the courthouse? (probably equipment). What about cable inside the courthouse? (generally thought to be part of the courthouse infrastructure, and thus facilities). Is a sound system for use in courtrooms an operating expense or part of the facility? (an infrastructure item, and thus part of the facility). What about court security equipment like metal detectors? (security is the sheriff's responsibility, and if the equipment is permanent, is part of the infrastructure). Sometimes the line is clear—furniture, drapes, and fixtures are part of the facility, and computers and specialized court equipment are operating expenses. But often

the distinction is not clear, and is usually resolved through negotiation.

Sometimes the issue is a different one—is the facility or the furnishing of the facility "adequate"? In such cases, the initial determination is made by the county when it allocates and maintains the space allocated to the courts, pursuant to its general authority to control the use of its property. When court officials or users question the adequacy, they almost always do so informally, and usually the issue can be settled there. But if court officials or users of the courts believe that the county's decision about allocation of facilities does not result in "adequate" facilities, the North Carolina Supreme Court has indicated that it is possible for the county to be sued to force it to provide adequate facilities. If that litigation results in a decision that a complained-of facility is inadequate, the court may order the county to provide an adequate facility. The county generally has the discretion to decide how to remedy the inadequacy. If it fails to take action, or if its action is found to be inadequate, the court could then hold the appropriate officials in contempt of court, although as of December 2005, no case had ever reached that stage. Negotiated settlements are almost always reached before that stage of litigation results.

If the facility is a municipal district court, the same process described previously for counties would be applicable, but the courts have additional options for dealing with the issue. The statutes authorize the director of the Administrative Office of the Courts to forbid the use of a municipal facility if he or she determines it to be inadequate (G.S. 7A-302). Additionally, a chief district court judge may simply direct that no cases be scheduled in a municipal facility if he or she finds it to be inadequate.

A "facilities fee" is collected in each court case as part of the court costs paid by the litigants. This fee is distributed to the counties (and a proportionate share goes to municipalities for the cases heard in municipally owned district court facilities) and must be spent exclusively for providing, maintaining, and constructing court facilities for court officials and court-related personnel, as well as for some related functions. Court-related personnel are generally thought to be the other employees administratively housed in the Judicial Department, such as family court or drug court personnel, trial court administrators, custody mediation personnel, and so on. Those other related functions, as listed in G.S. 7A-304, include jail and juvenile detention facilities, free parking for jurors, and a law library, including books. Sometimes court officials or others ask for an accounting of the use of the facilities fee, and under the public records law, they are entitled to that information. When the state assumed the costs of operating the trial courts in the 1960s, this fee was preserved as a local government source of revenue to help offset the continuing costs retained by the county for court operations. It is rarely sufficient to cover the entire cost of operating a court facility, and would never support the cost of construction of facilities.

Drennan, James C., "The Courts," Article 36, pp. 14-15 (September 1, 2006), in *Municipal and County Government in North Carolina,* ed. David Lawrence (Chapel Hill, NC: UNC School of Government), sog.unc.edu (accessed November 17, 2006). Draft.

Correctional System—Allocation of Responsibility

1. Responsibility for jails—Local obligation, with state regulation and inspection. GS 153A-216 et.seq.
2. Responsibility for prisons—State obligation. GS 148-4
3. Cost of pretrial detention—Local, subject to transfer to state for safekeeping. GS 148-32.1
4. Cost of post-conviction confinement—State/local mix. State has responsibility for all felons and misdemeanants with sentences over 90 days. For misdemeanants with sentences over 30 days, state pays county $18.50 per day plus most medical costs for the inmate. GS 15A-1352; 148-32.1
5. Cost of state prisoners awaiting transfer—State pays county $40 per day (after 6 days) plus medical costs for state prisoner held in local confinement facility pending transfer to Department of Correction. Length of stay depends on variety of factors, including state prison capacity. GS 148-29
6. Community corrections programs, state—Adult probation and parole
7. Community corrections program, local or nonprofit—Criminal justice partnership or local funding (pretrial release programs, intermediate punishment programs)

The North Carolina State Infrastructure Report Card as Reported by the North Carolina Section of ASCE

Presented to

The Fiscal Modernization Study Commission

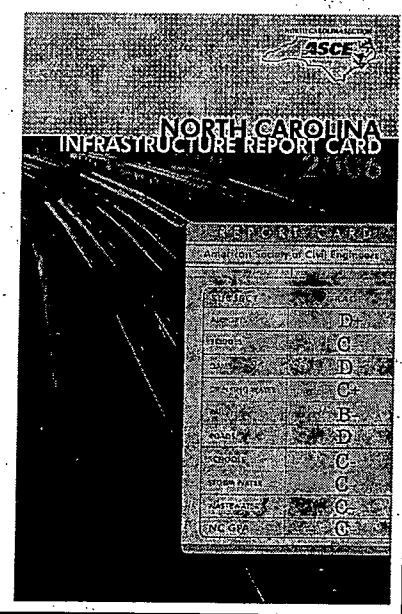
November 29, 2006

2006 North Carolina Infrastructure Report Card

NC GPA C-

Purpose:

Summarize
Benchmark
Educate
Emphasize



AIRPORTS – Grade D+

- Pavement Condition Rating – 30%
- Funding Needs v. Budget – 30%
- Safety – 20%
- Passenger Cost/Satisfaction – 20%

AIRPORTS – Composite Grade

- PCR – 65 % of sections tested rated less than [illegible] condition. Better pavement condition [illegible] Carrier Airports than General Aviation [illegible] Condition Grade of D.
- Due to shortfall in funding for both short and long terms, a Grade of F was assigned.
- Safety was assigned a Grade of B.
- Cost/satisfaction was given a Grade of C.

AIRPORTS – Funding Needs

- Aviation inputs approximately $9.5 billion to state's economy
- State's General Aviation Plan for 2007-2015 estimates a need of $588 million
- The 25-year Aviation Plan identified funding needs of $1.72 billion ($1,720,000,000)
- At present level of funding only pavement upkeep can be addressed.
- Airports Overall Grade of D+

BRIDGES – Ratings

Sufficiency Rating	# of Bridges
Less than 10	130
10-20	250
20-30	490
30-40	620
40-50	1,160

- Over 2,650 have a SR less than 50

BRIDGES – Overall Grade C-

- 32% of North Carolina's 17,803 highway bridges are considered structurally deficient or functionally obsolete. Grade of D+
- Based upon current deficient bridges and current funding/spending rates, it will be 2083 (77 years) to complete replacement. Grade of D.
- Inspections received a Grade of B.
- Overall Bridges Grade of C-

BRIDGES – Recommendations

- Halt use of Highway Trust Fund for non-transportation related projects.
- Life-cycle cost analysis principles should be used to evaluate the total cost of bridge replacement projects.
- Environmental streamlining should be supported for bridge replacement projects.

DAMS – Classification

Hazard Classification	Number of Dams
High	1,148
Intermediate	764
Low	3,338
Total	5,250

DAMS – Conditions

- 15 full time inspectors statewide.
- In 2005, 1,485 dams were inspected and a total of 143 Notice of Deficiency were noted. 93 high hazard, 28 intermediate.
- Only 195 high hazard dams in NC have a Emergency Action Plan on record and none meet current Federal Guidelines for Dam Safety.

DAMS – Grade of D

- Grade of F for funding, as no funding source is in place for repair or removal of existing dams.
- Grade of F for Emergency Action Plans.
- Grade of B for condition.
- Overall Grade of D.

DAMS - Recommendations

- Develop Emergency Action Plans for all High Hazard Dams in the State.
- Reauthorize the National Dam Safety Program (S. 2735/H.R. 4981).
- Develop a comprehensive information resource system to support the maintenance and improvement of dam safety.
- Increase staff and budget for the Dam Safety Office to accommodate for current and future inspection needs and permitting reviews.

DRINKING WATER – Background

- Approximately 7,000 public water systems serve approximately 5.5 million people. Of the 7,000, about 530 municipal water systems serve 67% of the population.
- In 2002, 90 of the municipal systems were placed on mandatory water restrictions and many other implemented voluntary conservation measures.
- About half of the 530 municipal water systems serve 2,500 people or less and 70% serve fewer than 5,000. Therefore, about 375 small systems.

DRINKING WATER – Assessment

- Overall deterioration of most water mains installed over 50 years ago.
- Statewide average of unaccounted for water is 11%.
- Some systems loose as much as 20% in unaccounted for water.
- Generally the majority of the systems (smaller ones) in North Carolina collect smaller amounts for their annual utility services than the EPA recommended system wide average of 4.5% of median household income.

DRINKING WATER – Funding/Need

- EPA funding to grant/loan funds has been decreasing since about 1990.
- Regulations continue to become more complex and stringent without adequate federal budget allocation.
- In 2003, EPA Drinking Water Survey, 20-year need of $10.98 billion for North Carolina.
- NC Rural Economic Development Center (Water 2030, May 2006), 5-year funding need over $2.5 billion with over $4.5 billion through year 2030.

DRINKING WATER – Grade C+

- Grade of C for North Carolina's ability to make required system improvements with available funds.
- Grade of C+ for North Carolina's water system physical condition and current need to reduce the system wide UAW.
- Grade of C- for North Carolina's water system's ability to meet funding need without state subsidy.

DRINKING WATER - Recommendations

- Overall reduction of unaccounted for [illegible] each utility.
- Continue public education campaigns [illegible] gaining acceptance of rates that can support [illegible] cycle asset management funding.
- Continue to implement rates that encourage water efficiency.
- State supported long term funding of water infrastructure.

RAIL – Background, Freight

- 2004 Rail - 15.5 million tons of goods originated in North Carolina.
- 2004 Rail - 61.1 million tons of goods terminated in North Carolina.
- Only 30% of the state's short lines can accommodate the new, heavier rail cars.

RAIL – Background, Passenger

- In 2005, more than 520,000 Amtrak passenger boardings in the state.
- In 1992, USDOT designated the Washington, D.C.-Raleigh-Charlotte (Southeast High Speed Rail Corridor) as one of the most economically viable high-speed corridors in the country, as compared with four others.

RAIL – Grade B-

- Safety primary concern.
- Since 1993, NCDOT has eliminated approx. 114 public at grade crossings statewide.
- In 2005, North Carolina had 66 crashes, resulting in 6 deaths and 33 injuries.
- Since 2005, NC has planned a total of $20.7 million for installation of crossing warning devices statewide.

ROADS – Background

- North Carolina DOT is responsible for the second largest state maintained highway system in the nation.

Road Classification	Miles
Interstate Routes	1,084
Interstate Business Routes	70
US Routes	5,535
NC Routes	8,117
NC Secondary Routes	64,204
Total	79,009

ROADS – Overall Grade D

- Pavement Conditions Rating – PCR ≥ 80 excellent, PCR<60 poor. In general, only two [illegible] lane miles surveyed were considered good. Compared to national scale, NC is in the bottom eight states in terms of "percent poor" interstates. Grade of D.
- Congestion – 57% of all urban highway miles and 47% of rural miles are congested. NC degree of congestion is one of the highest in the country with only California and New Jersey reporting higher levels. Grade of D.

ROADS – Overall Grade D

- Funding – NCDOT long range transportation improvement plan projected a shortfall of $29 billion by 2025 (25 year horizon). Recent diversion of funds from Trust Fund to the General Fund decreasing funds available for transportation purposes. Grade of F.
- Safety – NC ranked 4th for traffic fatalities in 2005, exceeded by California, Florida and Texas. But 12th in terms of fatalities per registered vehicles. Grade of D.

ROADS – Recommendations

- Support continued implementation of design and construction practices.
- Continue to consider alternatives for increasing funds available for roads through sources such as toll roads, bond issues, etc.
- Encourage shift from prescriptive specifications to performance based specifications.
- Development of realistic, fact based life cycle cost analysis methods and implement them as primary decision tools as opposed to "lowest price".

SCHOOLS – Overall Grade C-

- Over 46% of all North Carolina's public schools (2,242) surveyed require renovation in the next five years. Grade of D
- Approximately 8.5% (190) schools will be considered obsolete in next five years. Grade of
- Capacity – 13% of all NC students are taught in mobile classrooms. Over 1,100 of the state's existing schools will require additions in the next five years. Grade of C
- Overall Grade of C-

SCHOOLS – Recommendations

- Support increased use of school construction bonds.
- Encourage school districts to explore alternative financing to facilitate construction, including lease/financing and financing/ownership/use arrangements.
- Consider direct funding for school construction.
- Ensure the money earmarked for public school systems is used for intended purpose.

STORM WATER – Overall Grade C-

- Over 60% of communities statewide [illegible] development regulations to prevent [illegible] development in floodplains. Grade of C-
- Management – only 16% of the state's system possess a current map of their storm water system. Grade of D+.
- Policy – 135 communities have established or will soon be under NPDES Phase II storm water permitting process. Grade of B.
- Funding – less than 6% of communities reported having a dedicated revenue source for storm water. Grade of D-

STORM WATER – Recommendations

- Continuation and support for the newly developed NC Rural Center statewide inventory [illegible]
- Encourage regional cooperation and management of storm water, including inter-local agreements, multi-objective planning and management
- Continued implementation of NPDES Phase II permitting, continued enacting of guidelines to prevent floodplain development

WASTE WATER – Background

- North Carolina has over 400 public [illegible] systems statewide that provide approximately 51% of the state's population with wastewater service
- Over 80% of these systems are owned and operated by incorporated municipalities
- Approximately 4.4 million people statewide receive public waste water service
- Current state population growth rate expected to move NC to 8th most populous state by 2010

WASTE WATER – Overall Grade C-

- Wastewater flows exceed treatment capacity at approximately 40% of the state's 3[illegible] wastewater treatment plants on highest [illegible] Grade of C-
- Approximately $7.52 billion in unmet funding needs over a 25-year period. Grade of D.
- From 1995 to 2005, private loans accounted for 70% of total financing of water and sewer projects in NC, and due to poor bond ratings approximately 60% of NC local governments cannot qualify. Grade of C-.

WASTE WATER - Recommendations

- Overall reduction in infiltration and inflow [illegible] utilities statewide.
- Support long-term funding of waste water infrastructure projects and continue to encourage regionalization.
- Continue public education campaigns focused on gaining acceptance of rates that can support life cycle asset management funding.
- Continue to implement rates that encourage water efficiency.

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North Carolina

Corporation Income and Business Franchise Taxes

Tax Year 2003

Statistics and Trends

Policy Analysis and
Statistics Division

North Carolina

Corporation Income and Business Franchise Taxes

Tax Year 2003

Statistics and Trends

Policy Analysis and Statistics Division
May 2006

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CONTENTS

INTRODUCTION.....1

TAXES COVERED BY THIS REPORT.....2

SECTION I - FRANCHISE TAX

C-Corporation.....4
Table 1.1: C-Corporation Returns by Tax Base Utilized
Table 1.2: C-Corporation Net Franchise Tax Liability by Tax Base Utilized
Figure 1.3: C-Corporation Returns and Net Franchise Tax Liability by Tax Base
Table 1.4: C-Corporation Returns and Net Franchise Tax Liability by Franchise Taxable Amount
Figure 1.5: C-Corporation Returns and Net Franchise Tax Liability by Franchise Taxable Amount
Table 1.6: C-Corporation Returns Claiming Franchise Tax Credits and Amount of Credits Taken
Figure 1.7: C-Corporation Returns Claiming Franchise Tax Credits and Amount of Credits Taken
Figure 1.8: C-Corporation Franchise Tax Credits Taken by Credit Type and Franchise Taxable Amount

S-Corporation.....8
Table 1.9: S-Corporation Returns by Tax Base Utilized
Table 1.10: S-Corporation Net Franchise Tax Liability by Tax Base Utilized
Figure 1.11: S-Corporation Returns and Net Franchise Tax Liability by Tax Base
Table 1.12: S-Corporation Returns and Net Franchise Tax Liability by Franchise Taxable Amount
Figure 1.13: S-Corporation Returns and Net Franchise Tax Liability by Franchise Taxable Amount
Table 1.14: S-Corporation Returns Claiming Franchise Tax Credits and Amount of Credits Taken
Figure 1.15: S-Corporation Returns Claiming Franchise Tax Credits and Amount of Credit Taken
Figure 1.16: S-Corporation Franchise Tax Credits Taken by Credit Type and Franchise Taxable Amount

C and S Corporations Combined.....12
Figure 1.17: C & S Corporation Returns and Net Franchise Tax Liability by Tax Base
Figure 1.18: C & S Corporation Returns and Net Franchise Tax Liability by Franchise Taxable Amount
Figure 1.19: C & S Corporations Returns Claiming Franchise Tax Credits and Amount of Credits Taken

SECTION II - INCOME TAX

C-Corporation.....15
Table 2.1: C-Corporation Returns and Net Income Tax Liability by NC Taxable Income
Figure 2.2: C-Corporation Returns and Net Income Tax Liability by NC Taxable Income
Figure 2.3: C-Corporation Returns and Net Income Tax Liability by Federal Taxable Income (Before NOL)
Table 2.4: C-Corporation Returns by Federal Taxable Income (Before NOL) and Apportionment Percentage
Table 2.5: C-Corporation Net Income Tax Liability by Federal Taxable Income (Before NOL) and Apportionment Percentage
Figure 2.6: C-Corporation Returns and Net Income Tax Liability by Apportionment Percentage
Table 2.7: C-Corporation Income Tax Calculation Detail by Federal Taxable Income (Before NOL)
Table 2.8: C-Corporation Returns by Income Tax Credits as a Percentage of Tax
Table 2.9: C-Corporation Tax Credits for Taxable Returns Income Tax Credits as a Percentage of Tax
Figure 2.10: C-Corporation Income Tax Credits Taken by Federal Taxable Income (Before NOL)
Table 2.11: C-Corporation Income Tax Credits by Credit Type and Federal Taxable Income (Before NOL)

S-Corporation.....22
Table 2.12: S-Corporation Returns and Net Income Tax Liability by NC Taxable Income
Figure 2.12: S-Corporation Returns and Net Income Tax Liability by NC Taxable Income
Figure 2.14: S-Corporation Returns by NC Taxable Income and Nonresident Shareholder Status
Table 2.15: S-Corporation Income Tax Calculation Detail
Table 2.16: S-Corporation Income Tax Credits by Credit Type and Taxable Income

SECTION III – TRENDS

C-Corporation.....26
Table 3.1: C-Corporation Returns by NC Taxable Income
Figure 3.2: C-Corporation Returns by Tax Years
Figure 3.3: C-Corporation Returns by NC Taxable Income
Table 3.4: C-Corporation Net Income Tax Liability by NC Taxable Income
Figure 3.5: C-Corporation Net Income Tax Liability by NC Taxable Income
Figure 3.6: C-Corporation Income Tax Credits by Credit Type
Table 3.7: C-Corporation Returns by Percentage of Income Tax Relieved by Income Tax Credits
Table 3.8: C-Corporation Credits by Percentage of Income Tax Relieved by Income Tax Credits
Figure 3.9: C-Corporation Returns by Apportionment Percentage
Figure 3.10: C-Corporation Net Income Tax Liability by Apportionment Percentage

S-Corporation.....31
Table 3.11: S-Corporation Returns by NC Taxable Income
Figure 3.12: S-Corporation Returns by Tax Years
Figure 3.13: S-Corporation Returns by NC Taxable Income
Table 3.14: S-Corporation Net Income Tax Liability by NC Taxable Income
Figure 3.15: S-Corporation Net Income Tax Liability by NC Taxable Income
Figure 3.16: S-Corporation Taxable Income by Nonresident Filing Status
Table 3.17: S-Corporation Income Tax Credits by Credit Type

INTRODUCTION

This report contains statistics concerning business franchise and income taxes imposed on corporations and limited liability companies under the Revenue Laws of North Carolina. It is designed to provide legislators, public officials, tax professionals, researchers, and other interested citizens of North Carolina with information about the characteristics of corporate taxpayers and how those taxpayers contribute to the State's tax revenues. The report includes both historical series of data and detailed reports for tax year 2003. It was prepared by the Department of Revenue's Policy Analysis and Statistics Division.

This report is based upon data submitted by corporations and limited liability companies on the CD-405, CD-401S, and CD-425 forms. Not all of the information on the forms is scanned into the Department's Integrated Tax Administration System (ITAS), so the amount of information available for the report was limited. Because taxpayers file these forms on a schedule related to the period of their fiscal year, and because they may file for an extension, not all of the forms for tax year 2003 were processed until October 2005.

In October 2005, all of the data elements from these forms contained in ITAS were downloaded from the system for analysis. Some of the forms upon which the report data was based had been audited by that time, but others had not yet been subject to audit. As such, the data may reflect errors made by taxpayers. The Policy Analysis and Statistics Division did examine the downloaded data in order to correct data errors that resulted from scanning the returns into ITAS.

The Policy Analysis and Statistics Division began downloading corporation income and franchise tax data for analysis in 2003, starting with the 2001 tax year. As a result, only three tax years of data are available for trend analysis. Detailed information on the 2001 and 2002 tax years was published in the 2004 and 2005 editions of the *Statistical Abstract of North Carolina Taxes*, which are available on request. This report is available on the Department's website at: http://www.dornc.com/publications/.

Questions regarding this report may be directed to Karl Knapp, Director of the Policy Analysis and Statistics Division, at (919) 733-7722.

TAXES COVERED BY THIS REPORT

The following descriptions of the General Business Franchise Tax and Corporation Income Tax reflect the tax law in effect for 2003. These descriptions are not official interpretations of the Revenue Laws and should not be relied upon as representing the position of the Secretary of Revenue.

FRANCHISE TAX

The general business franchise tax is levied on business corporations doing business in the State (including those electing federal S Corporation status). The tax is imposed on the largest of three alternate asset bases. These bases are (a) the amount of the capital stock, surplus, and undivided profits apportioned to the State (using the apportionment formula for corporation income); (b) 55 % of appraised value of property in the State subject to local taxation; or (c) the book value of real and tangible personal property in the State, less any debt outstanding which was created to acquire or improve real property in the State. The tax is $1.50 per $1,000 of taxable assets.

Limited Liability Companies (LLC's) are exempt from the franchise tax, but companies that have a significant ownership interest in an LLC may be required to pay franchise tax on their attributable share of the assets of the LLC. Electric power, water, and sewer utility companies are not subject to the general business franchise tax, but instead pay a franchise tax based on their gross receipts. The utilities franchise tax is not covered by this publication.

The minimum franchise tax for companies covered by the tax is $35. The tax on holding companies that receive 80% of their gross income from subsidiaries is capped at $75,000 if the company uses the capital stock, surplus, and undivided profits base.

CORPORATION INCOME TAX

The Corporation income tax applies to companies that do business in North Carolina and that do not elect S-corporation status. The calculation of taxable income begins with Federal Taxable Income before Net Operating Loss, less Special Deductions. Additions to income are required for items including taxes based on income, capital loss carry-over, certain royalties paid to related members, contributions, and expenses attributable to income not taxed. Deductions from income are allowed for items including U.S. obligation interest, capital loss not deducted on the Federal return, and certain royalty payments from related members.

The portion of this adjusted income that is subject to apportionment, less contributions to donees in other States, is apportioned to North Carolina based upon North Carolina's share of the corporation's property, payroll, and sales, with sales double-weighted in the formula. For several types of industries (utilities, construction contractors, securities dealers, loan companies, and corporations that receive more than 50% of their ordinary gross income from intangible property), apportionment is based only on the sales factor. Special apportionment rules apply to interstate carriers, railroads, and air and water transportation corporations. Income not subject to apportionment is allocated to North Carolina if the business activity generating the income is located in North Carolina.

Total income allocated to North Carolina may be reduced by the value of net economic loss, percentage depletion over cost depletion, and contributions to North Carolina donees. The net taxable income is taxed at a rate of 6.9%.

S-corporations also must file returns at the corporation level, but the income tax is paid by shareholders through the individual income tax. S-corporations do sometimes make payments on behalf of nonresident shareholders, and these payments are treated as corporation income tax. As a result, information concerning the income and tax liabilities of S-corporations also is included in this report.

C-CORPORATIONS

Table 1.1 shows the distribution of returns by franchise tax base. Capital stock, surplus and undivided profits base was used on 45% of the 2003 tax year returns, followed by investment in tangible property base (19%), and appraised values in property base (10%). Twenty-seven percent of the returns listed no assets because: 1) the taxpayer was exempt from franchise tax; 2) the 2003 tax year return was a final return; or 3) the taxpayer incorrectly completed the form.

Table 1.1
C-Corporation Returns by Tax Base Utilized
Tax Year 2003

Franchise Taxable Amount	Number of C-Corporation Returns				Total
	No Assets Listed	Stock, Surplus & Profits	Investment in Tangible Property in N.C.	Appraised Value of Property in N.C.	
$0-$23,667	21,631	8,955	3,103	2,358	36,047
$23,668-$100,000	-	7,334	3,890	2,192	13,416
$100,001-$1,000,000	-	12,820	5,270	2,419	20,509
$1,000,001-$5,000,000	-	3,853	1,572	521	5,946
$5,000,001-$20,000,000	-	1,642	663	118	2,423
$20,000,001-$40,000,000	-	467	183	27	677
$40,000,001+	-	626	227	25	878
Total	21,631	35,697	14,908	7,660	79,896

Note: Figures are based on both audited and unaudited returns.

Table 1.2 and Figure 1.3 provide the number of C-corporation returns and net franchise tax liability by tax base utilized. The greatest share of tax paid (74%) was under the capital stock, surplus and undivided profits base. The investment in tangible property and appraised value in property bases represented much smaller shares of the net tax liability.

Table 1.2
C-Corporation Net Franchise Tax Liability by Tax Base Utilized
Tax Year 2003

Franchise Taxable Amount	Net Tax Liability ($)				Total
	No Assets Listed	Stock, Surplus & Profits	Investment in Tangible Property in N.C.	Appraised Value of Property in N.C.	
$0-$23,667	565,700	306,449	102,981	75,770	1,050,900
$23,668-$100,000	-	579,822	284,356	150,070	1,014,248
$100,001-$1,000,000	-	6,320,884	2,258,472	1,006,971	9,586,327
$1,000,001-$5,000,000	-	12,126,077	4,557,090	1,421,291	18,104,458
$5,000,001-$20,000,000	-	23,503,834	8,918,799	1,571,981	33,994,614
$20,000,001-$40,000,000	-	18,278,853	6,764,689	1,034,189	26,077,731
$40,000,001+	-	120,234,686	33,266,551	3,325,404	156,826,641
Total	565,700	181,350,605	56,152,938	8,585,676	246,654,919

Note: Figures are based on both audited and unaudited returns.

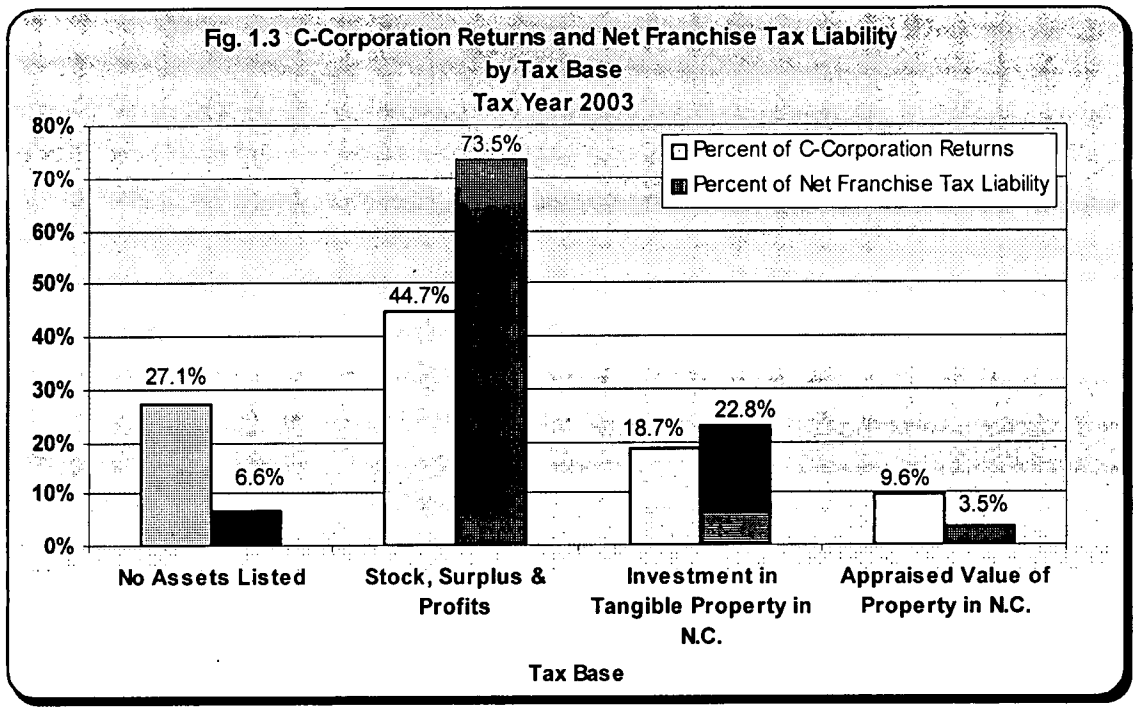


Table 1.4 and Figure 1.5 provide the distribution of C-corporation returns and net franchise tax liability. The top 5% of the returns, by taxable amount, paid 88% of the tax. Taxpayers with franchise taxable amount over $40 million made up 1% of the returns, but paid 64% of net franchise tax.

Table 1.4
C-Corporation Returns and Net Franchise Tax Liability by Franchise Taxable Amount
Tax Year 2003

Franchise Taxable Amount	Number of Returns	Percent	Net Franchise Tax Liability ($)	Percent
$0-$23,667	36,047	45.1%	1,050,900	0.4%
$23,668-$100,000	13,416	16.8%	1,014,248	0.4%
$100,001-$1,000,000	20,509	25.7%	9,586,327	3.9%
$1,000,001-$5,000,000	5,946	7.4%	18,104,458	7.3%
$5,000,001-$20,000,000	2,423	3.0%	33,994,614	13.8%
$20,000,001-$40,000,000	677	0.8%	26,077,731	10.6%
$40,000,001+	878	1.1%	156,826,641	63.6%
Total	79,896	100.0%	246,654,919	100.0%

Note: Figures are based on both audited and unaudited returns. Detail may not add to totals due to rounding or taxpayer error.

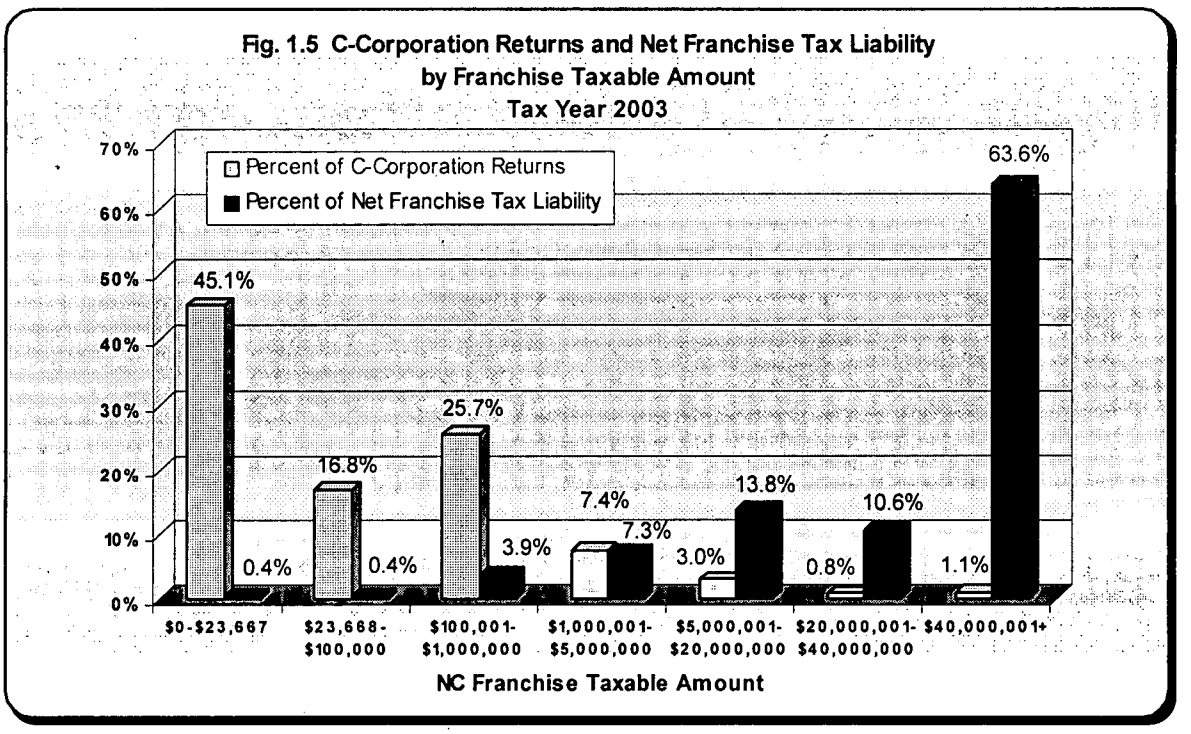


Table 1.6 and Figure 1.7 show the number of returns claiming franchise tax credits and amount of credits taken. Returns with franchise taxable amount greater than $40 million, comprised of only 3.5% of the returns claiming credits, but claimed 82% of the credits.

Table 1.6
C-Corporation Returns Claiming Franchise Tax Credits and Amount of Credits Taken
Tax Year 2003

Franchise Taxable Amount	Number of Returns Claiming Credits	Percent	Amount of Credits Taken ($)	Percent
$0-$23,667	1,174	10.1%	19,243	0.0%
$23,668-$100,000	2,258	19.4%	86,830	0.2%
$100,001-$1,000,000	5,052	43.4%	1,044,291	2.3%
$1,000,001-$5,000,000	1,792	15.4%	1,816,664	4.1%
$5,000,001-$20,000,000	727	6.2%	2,745,811	6.2%
$20,000,001-$40,000,000	238	2.0%	2,194,963	4.9%
$40,000,001+	402	3.5%	36,619,620	82.2%
Total	11,643	100.0%	44,527,422	100.0%

Note: Figures are based on both audited and unaudited returns. Detail may not add to totals due to rounding or taxpayer error.

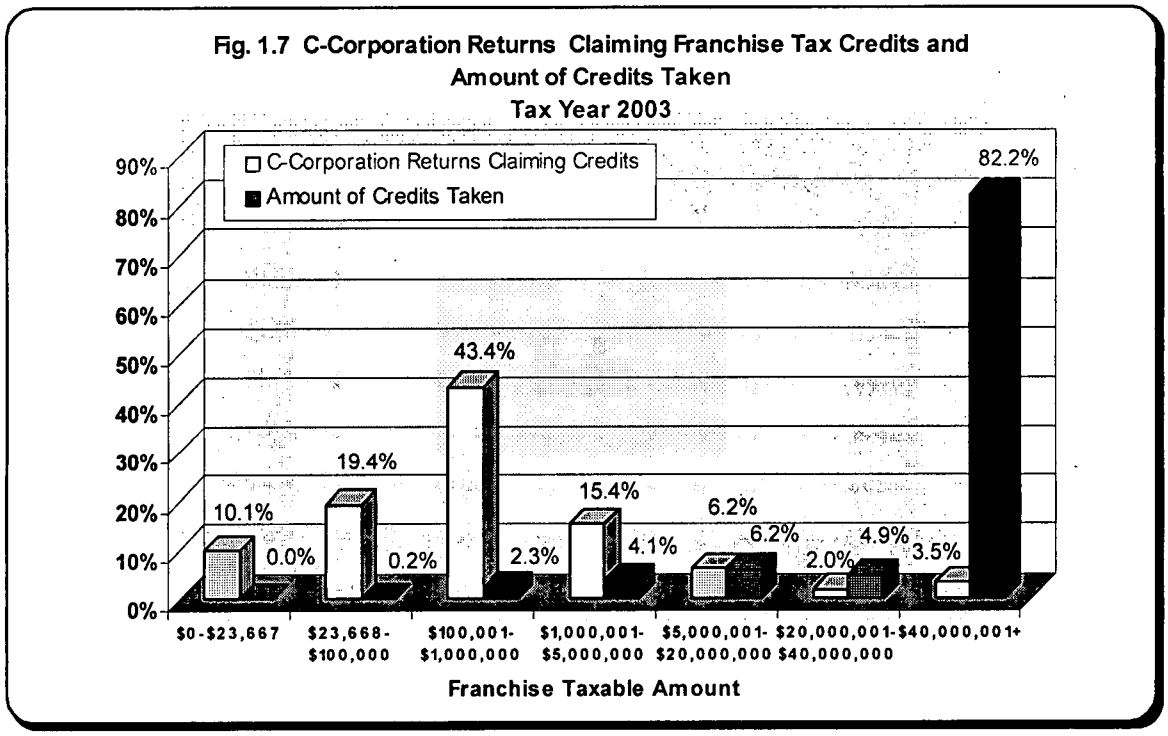


Table 1.8 shows the amount of franchise tax credits by credit type and franchise taxable amount.

Table 1.8
C-Corporation Franchise Tax Credits Taken by Credit Type and Franchise Taxable Amount
Tax Year 2003

	All Returns		Taxable Amount <$5,000,001		Taxable Amount $5,000,001+	
Income Tax Credits	Number of Credits *	Amount Claimed ($)	Number of Credits	Amount Claimed ($)	Number of Credits	Amount Claimed ($)
Short Period Credit for Change in Income Year	415	3,577,999	307	249,237	108	3,328,762
Piped Natural Gas	5	31,781,162	w	w	w	w
Investing in Recycling Facilities	3	888,340	w	w	w	w
Lee Act and Other Limited Credits	11,286	37,531,102	10,000	2,800,342	1,286	34,730,760
Credits Claimed	11,709	73,778,603	10,308	3,049,584	1,401	70,729,019
Credits Not Taken **	--	29,251,181	--	82,556	--	29,168,625
Credits Taken	--	44,527,422	--	2,967,028	--	41,560,394

w Withheld to protect taxpayer confidentiality.
* The total number of credits does not equal to the total number of returns claiming credits stated in Table 1.6.
** Credits were not taken against tax because taxpayer's liability was less than the amount of credits claimed or because of taxpayer error.

Note: Confidentiality prevents the disclosure of the individual credits and credits amount. Figures are based on both audited and unaudited returns. Detail may not add to totals due to rounding or taxpayer error.

S-CORPORATIONS

Table 1.9 shows the distribution of returns by franchise tax base. Capital stock, surplus and undivided profits base was used on 38% of 2003 tax year returns, followed by investment in tangible property base (26%), and appraised values in property (15%). Twenty percent of the returns listed no assets because: 1) the taxpayer was exempt from franchise tax; 2) the 2003 tax year return was a final return; or 3) the taxpayer incorrectly completed the form.

Table 1.9
S-Corporation Returns by Tax Base Utilized
Tax Year 2003

Franchise Taxable Amount	Number of S-Corporation Returns				Total
	No Assets Listed	Stock, Surplus & Profits	Investment in Tangible Property in N.C.	Appraised Value of Property in N.C.	
$0-$23,667	22,868	18,438	9,196	6,683	57,185
$23,668-$100,000	-	11,244	9,730	4,523	25,497
$100,001-$1,000,000	-	10,324	8,312	4,357	22,993
$1,000,001-$5,000,000	-	1,807	1,291	838	3,936
$5,000,001-$20,000,000	-	319	337	99	755
$20,000,001-$40,000,000	-	34	25	10	69
$40,000,001+	-	19	16	4	39
Total	22,868	42,185	28,907	16,514	110,474

Note: Figures are based on both audited and unaudited returns.

Table 1.10 and Figure 1.11 provide the number of S-corporation returns and net franchise tax liability by tax base utilized. The greatest share of tax paid (45%) was under the capital stock, surplus and undivided profits base. The investment in tangible property and appraised value in property bases represented smaller shares of the net tax liability.

Table 1.10
S-Corporation Net Franchise Tax Liability by Tax Base Utilized
Tax Year 2003

Franchise Taxable Amount	Net Tax Liability ($)				Total
	No Assets Listed	Stock, Surplus & Profits	Investment in Tangible Property in N.C.	Appraised Value of Property in N.C.	
$0-$23,667	649,755	636,574	312,870	225,865	1,825,064
$23,668-$100,000	-	861,915	735,730	329,416	1,927,061
$100,001-$1,000,000	-	4,585,174	3,312,229	2,016,171	9,913,574
$1,000,001-$5,000,000	-	4,791,942	3,747,871	2,206,899	10,746,712
$5,000,001-$20,000,000	-	3,888,718	4,176,549	1,195,122	9,260,389
$20,000,001-$40,000,000	-	1,331,074	866,039	349,635	2,546,748
$40,000,001+	-	1,919,971	1,486,816	329,093	3,735,880
Total	649,755	18,015,368	14,638,104	6,652,201	39,955,428

Note: Figures are based on both audited and unaudited returns.

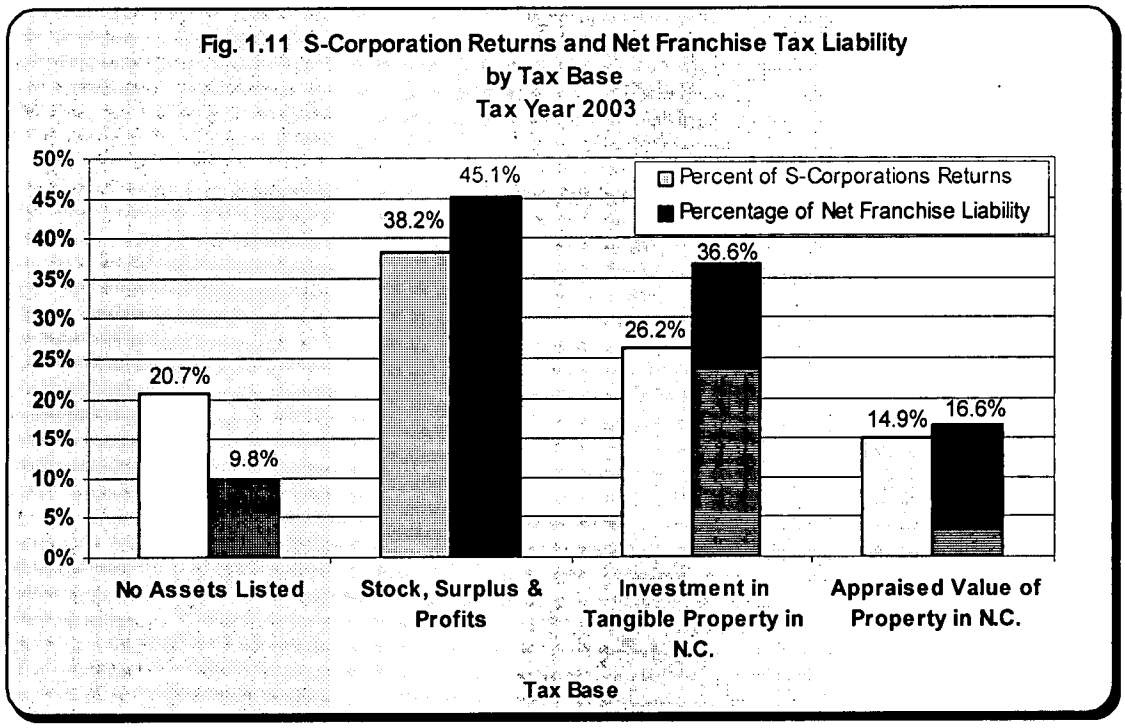


Table 1.12 and Figure 1.13 provide the distribution of S-corporation returns and net franchise tax liability. The top 5% of returns, by taxable amount, paid 66% of the tax. Taxpayers with franchise taxable amount between $1 million and $5 million, paid the largest amount of net franchise tax.

Table 1.12
S-Corporation Returns and Net Franchise Tax Liability by Franchise Taxable Amount
Tax Year 2003

Franchise Taxable Amount	Number of Returns	Percent	Net Franchise Tax Liability ($)	Percent
$0-$23,667	57,185	51.8%	1,825,064	4.6%
$23,668-$100,000	25,497	23.1%	1,927,061	4.8%
$100,001-$1,000,000	22,993	20.8%	9,913,574	24.8%
$1,000,001-$5,000,000	3,936	3.6%	10,746,712	26.9%
$5,000,001-$20,000,000	755	0.7%	9,260,389	23.2%
$20,000,001-$40,000,000	69	0.1%	2,546,748	6.4%
$40,000,001+	39	0.0%	3,735,880	9.4%
Total	110,474	100.0%	39,955,428	100.0%

Note: Figures are based on both audited and unaudited returns. Detail may not add to totals due to rounding or taxpayer error.

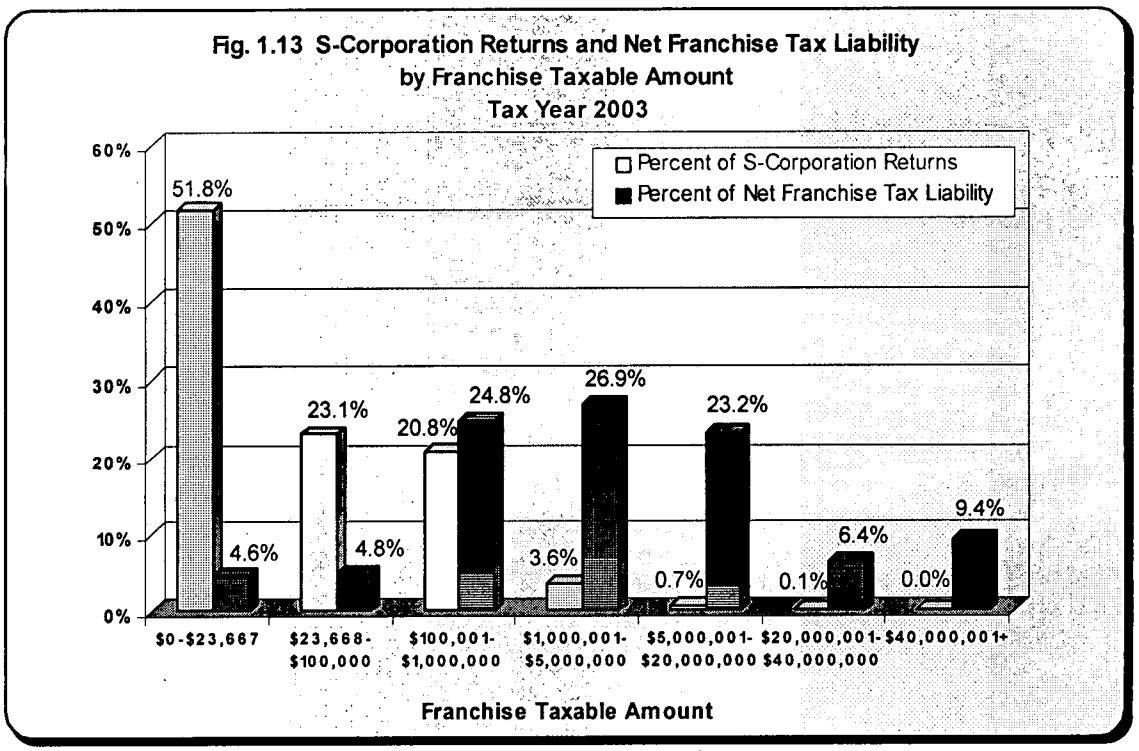


Table 1.14 and Figure 1.15 show the number of returns claiming franchise tax credits and amount of credits taken. Returns with a franchise taxable amount between $1 million and $5 million comprised 16% of the returns claiming credits and claimed 36% of the credits.

Table 1.14
S-Corporation Returns Claiming Franchise Tax Credits and Amount of Credits Taken
Tax Year 2003

Franchise Taxable Amount	Number of Returns Claiming Credits	Percent	Amount of Credits Taken ($)	Percent
$0-$23,667	1,451	15.0%	22,520	0.6%
$23,668-$100,000	2,191	22.6%	77,721	2.0%
$100,001-$1,000,000	4,021	41.4%	797,338	20.7%
$1,000,001-$5,000,000	1,531	15.8%	1,365,415	35.5%
$5,000,001-$20,000,000	440	4.5%	970,578	25.2%
$20,000,001-$40,000,000	41	0.4%	183,975	4.8%
$40,000,001+	28	0.3%	433,142	11.2%
Total	9,703	100.0%	3,850,689	100.0%

Note: Figures are based on both audited and unaudited returns. Detail may not add to totals due to rounding or taxpayer error.

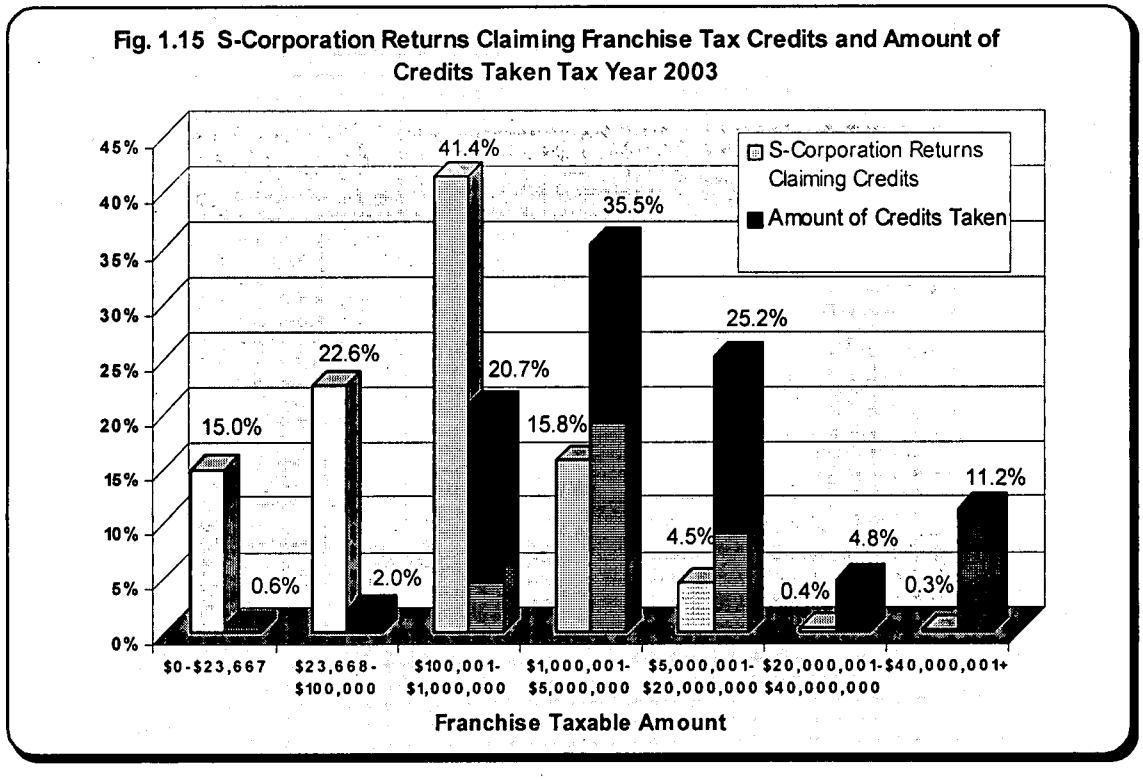


Table 1.16 shows the amount of franchise tax credits by credit type and franchise taxable amount.

Table 1.16
S-Corporation Franchise Tax Credits Taken by Credit Type and Franchise Taxable Amount
Tax Year 2003

Income Tax Credits	All Returns Number of Credits*	All Returns Amount Claimed ($)	Taxable Amount <$5,000,001 Number of Credits	Taxable Amount <$5,000,001 Amount Claimed ($)	Taxable Amount $5,000,001+ Number of Credits	Taxable Amount $5,000,001+ Amount Claimed ($)
Short Period Credit for Change in Income Year	109	73,360	104	47,443	5	25,917
Lee Act and Other Limited Credits	9,628	3,786,432	9,121	2,228,058	507	1,558,374
Piped Natural Gas/Investing in Recycling Facilities	4	7,952	w	w	w	w
Credits Claimed	9,741	3,867,744	9,228	2,275,538	513	1,592,206
Credits Not Taken **	--	17,055	--	12,544	--	4,511
Credits Taken	--	3,850,689	--	2,262,994	--	1,587,695

w Withheld to protect taxpayer confidentiality.
* The total number of credits does not equal to the total number of returns claiming credits stated in Table 1.14.
** Credits were not taken against tax because taxpayer's liability was less than the amount of credits claimed or because of taxpayer error.

Note: Confidentiality prevents the disclosure of the individual credits and credits amount. Figures are based on both audited and unaudited returns. Detail may not add to totals due to rounding or taxpayer error.

C & S CORPORATIONS COMBINED

Figure 1.17 shows the number of returns and net franchise tax liability for all C and S corporations combined. The largest amount of net franchise tax was paid by the returns having capital stock, surplus and profits as the tax base. Twenty-three percent of the returns listed no assets because: 1) the taxpayer was exempt from franchise tax; 2) the 2003 tax year return was a final return; 3) or the taxpayer incorrectly completed the form.

Fig. 1.17 C & S Corporation Returns and Net Franchise Tax Liability by Tax Base
Tax Year 2003

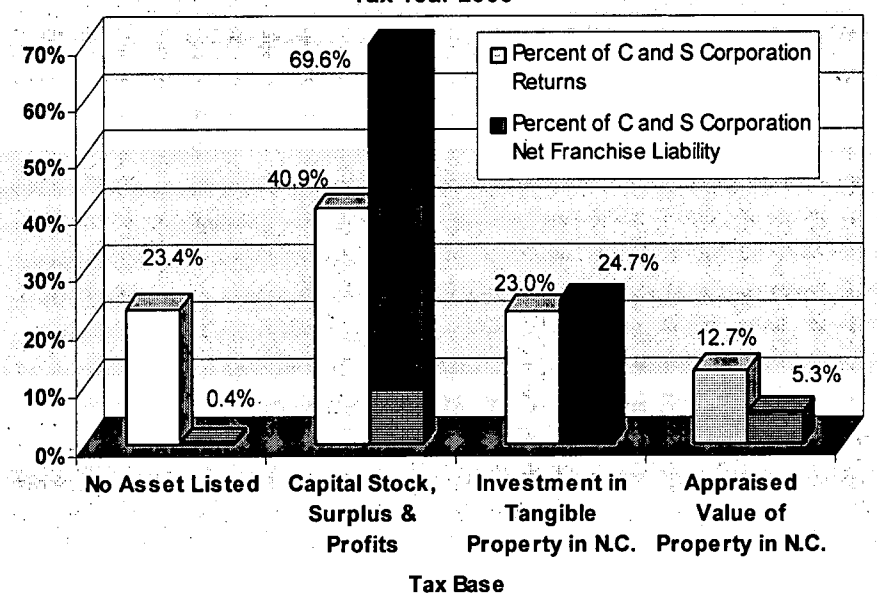


Figure 1.18 shows the number of C and S corporation returns and net franchise tax liability. The top 3% of returns, by taxable amount, paid 81% of the tax. Taxpayers with franchise taxable amount over $40 million made up 1% of the returns, but paid 56% of net franchise tax.

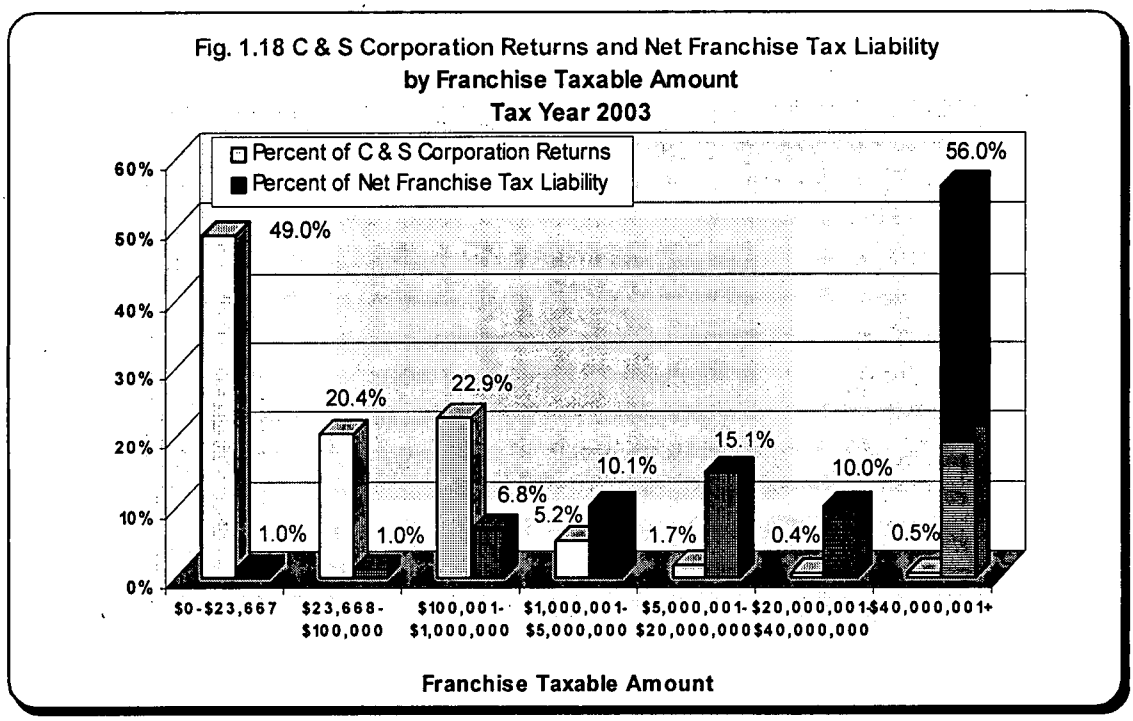
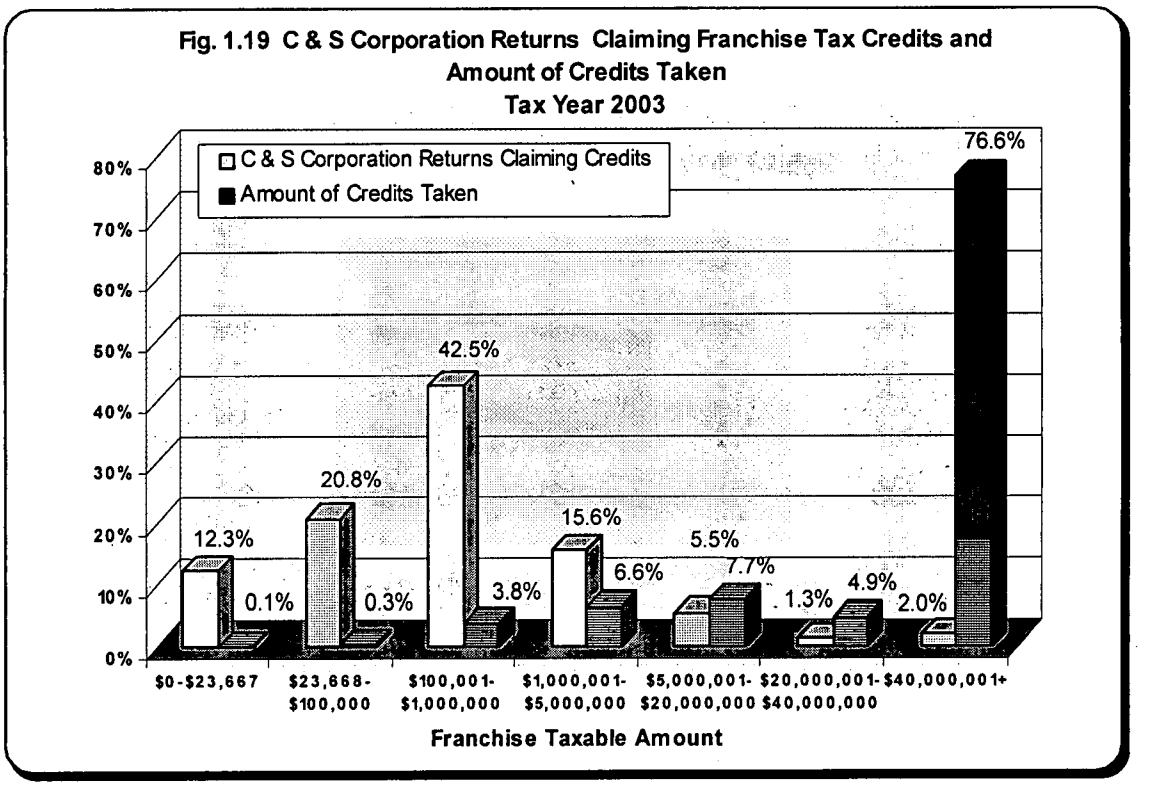


Figure 1.19 shows the number of C and S corporation returns claiming franchise tax credits and the amount of credits claimed. Corporations with over $40 million as their franchise taxable amount claimed the greatest amount of credits.



C-CORPORATIONS

Table 2.1
C-Corporation Returns and Net Income Tax Liability by NC Taxable Income
Tax Year 2003

NC Taxable Income	Number of Returns	Percent	Net Income Tax Liability * [$]	Percent
$0 **	53,308	66.72%	--	--
$1-$15,000	13,397	16.77%	3,776,491	0.52%
$15,001-30,000	3,156	3.95%	4,519,503	0.62%
$30,001-$50,000	2,256	2.82%	5,788,197	0.80%
$50,001-$100,000	2,517	3.15%	11,676,194	1.61%
$100,001-$500,000	3,218	4.03%	48,488,171	6.67%
$500,001-$1,000,000	739	0.92%	35,376,798	4.87%
$1,000,001-$10,000,000	1,151	1.44%	215,641,627	29.66%
$10,000,001+	154	0.19%	401,674,284	55.26%
Total	79,896	100.00%	726,941,265	100.00%

* Net tax liability is prior to the application of the refundable credit in G.S. 105-129.28. Because this credit is limited to a very small number of taxpayers, including its effects would violate taxpayer confidentiality.

** Includes both returns with no Federal Taxable Income and those that have Federal Taxable Income, but no NC Taxable Income.

Note: Figures are based on both audited and unaudited returns. Detail may not add to totals due to rounding or taxpayer error.

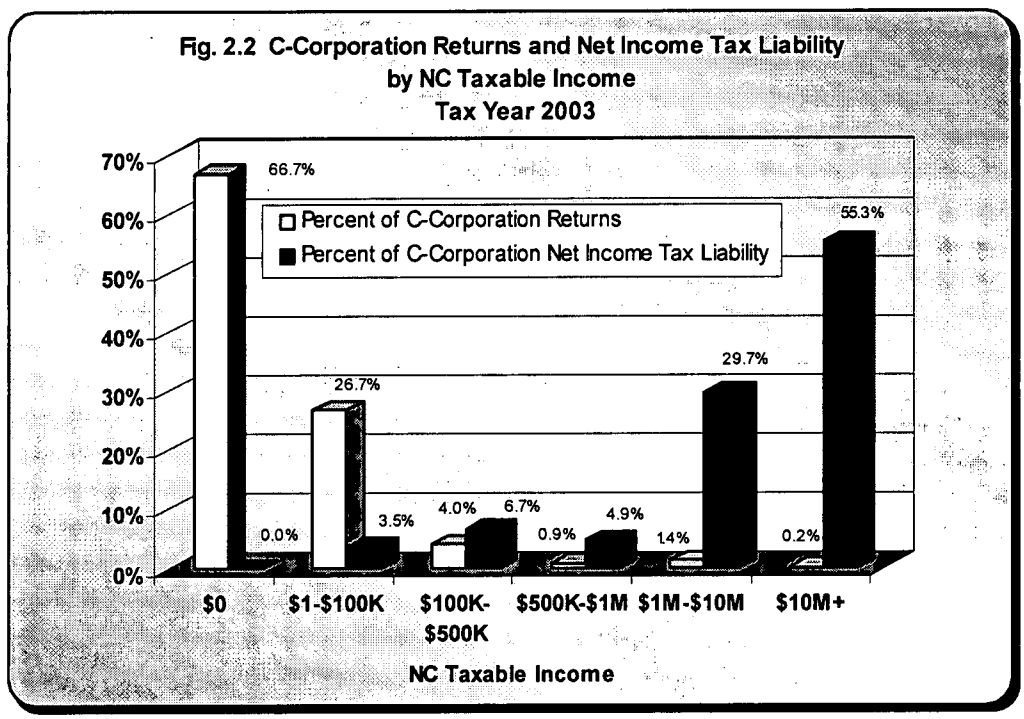


Table 2.1 and Figure 2.2 show the distribution of returns and net income tax liability by taxable income. Some corporations have no federal taxable income but pay North Carolina taxes because provisions of the State tax code require that they add back certain amounts, such as income taxes paid, to their taxable income. Other corporations have a positive federal taxable income but pay no tax in North Carolina because some of their income is not subject to taxation by states or because provisions of the State tax code allow them to reduce their taxable income to zero.

Although almost 80,000 C-corporations were subject to the corporation income tax in tax year 2003, only one-third of the corporations that filed a return actually had a tax liability.

Two-thirds of the C-corporation returns filed for tax year 2003 had no North Carolina Taxable Income. Within this group of 53,308 corporations, 41,384 (78%) had a Federal Taxable Income of zero or less. The remaining C-corporations had positive Federal Taxable Income, but their adjustments to income, non-apportionable income allocated to other States, net economic loss, or other reductions reduced the taxable income to zero.

Among those C-corporations that did have a tax liability, over half had NC Taxable Income of less than $15,000. Less than 1% of the total C-corporation income tax liability was attributable to this group of corporations. At the other end of the spectrum, corporations with a North Carolina Taxable Income of over $1 million represented nearly 85% of the C-corporation income tax liability, but made up less than 2% of the corporations filing returns. Over half of the total corporation income tax liability was attributable to the 154 corporations with North Carolina Taxable Income of over $10 million.

Figure 2.3 provides the distribution of returns and tax liability by federal taxable income. Corporations with federal taxable income over $35 million paid the largest amount of net income tax.

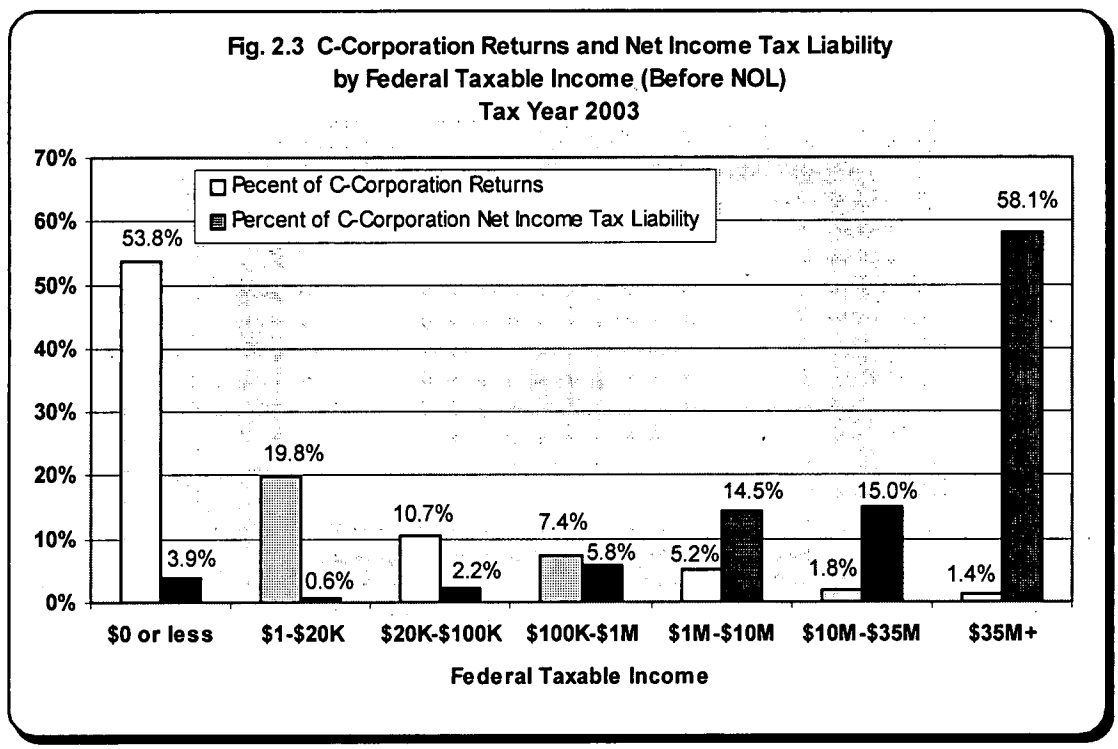


Table 2.4 and Figure 2.6 show the distribution of returns by apportionment percentage and federal taxable income. A corporation's apportionment percentage is used to determine how much of the corporation's income may be taxed by North Carolina. The percentage is based on how much of the corporation's property, payroll, and sales are in North Carolina, with sales being given a double weight.

Table 2.4
C-Corporation Returns by Federal Taxable Income (Before NOL) and Apportionment Percentage
Tax Year 2003

	NC Apportionment Percentage					
Federal Taxable Income	**<5%**	**5% - 24%**	**25% - 49%**	**50% - 99%**	**100%**	**Total**
$0 or less	11,976	1,917	717	1,132	27,259	43,001
$1 - $20,000	803	243	126	299	14,332	15,803
$20,001- $100,000	1,112	381	177	377	6,476	8,523
$100,001 - $ 1,000,000	2,360	650	262	495	2,121	5,888
$1,000,001 - $10,000,000	2,889	580	200	194	277	4,140
$10,000,001-$35,000,000	1,159	195	46	32	23	1,455
$35,000,001+	928	123	22	10	3	1,086
Total	21,227	4,089	1,550	2,539	50,491	79,896

Note: Figures are based on unaudited returns.

Table 2.5
C-Corporation Net Income Tax Liability by Federal Taxable Income (Before NOL) and Apportionment Percentage *
Tax Year 2003

	NC Apportionment Percentage					
Federal Taxable Income	**<5%** [$]	**5% - 24%** [$]	**25% - 49%** [$]	**50% - 99%** [$]	**100%** [$]	**Total** [$]
$0 or less	7,270,434	4,904,396	492,359	12,740,092	2,626,179	28,033,460
$1 - $20,000	153,572	41,988	33,234	168,486	3,937,431	4,334,711
$20,001- $100,000	167,313	226,194	182,347	910,054	14,486,090	15,971,998
$100,001 - $ 1,000,000	876,038	2,037,049	2,480,216	6,723,130	30,267,819	42,384,252
$1,000,001 - $10,000,000	9,803,975	15,119,768	15,051,740	25,701,106	39,484,914	105,161,503
$10,000,001-$35,000,000	21,914,289	23,129,642	17,173,915	23,250,128	23,569,401	109,037,375
$35,000,001+	126,167,298	166,172,966	48,588,446	64,625,117	16,464,139	422,017,966
Total	166,352,919	211,632,003	84,002,257	134,118,113	130,835,973	726,941,265

* Net tax liability is prior to the application of the refundable credit in G.S. 105-129.28. Because this credit is limited to a very small number of taxpayers, including its effects would violate taxpayer confidentiality.

Note: Figures are based on both audited and unaudited returns.

Table 2.5 and Figure 2.6 show the net income tax liability by apportionment percentage and federal taxable income. C-corporations that operate exclusively within North Carolina, and so apportion all of their income to the state, made up over 60% of the returns filed for tax year 2003. These corporations accounted for less than 18% of the corporation income tax liability, however, largely because the majority of them had Federal Taxable Income of zero or less.

The State receives a significant portion of its corporation income taxes from a small number of large multi-state firms. Over 40% of corporation income tax was attributable to 1,051 corporations with Federal Taxable Income of over $35 million that apportioned less than 25% of their income to North Carolina. The economic success, sales patterns, and tax planning decisions of this relatively small number of large, multi-state companies can significantly affect North Carolina's corporation income tax revenues.

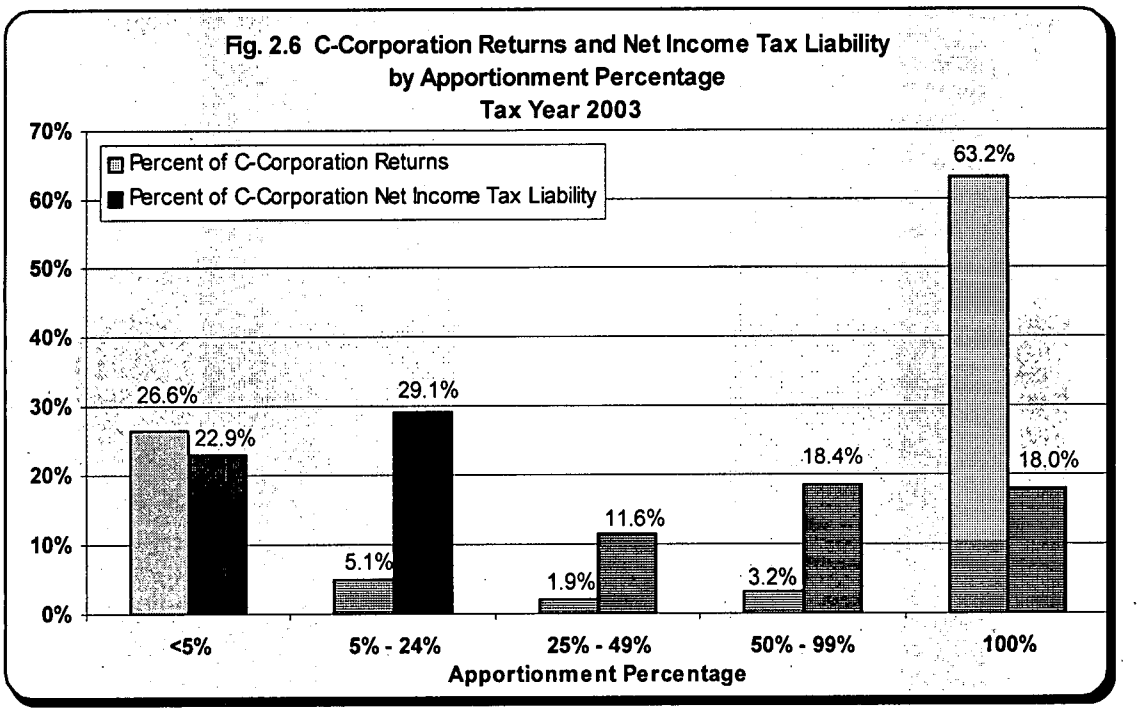


Table 2.7 shows the income tax calculation detail by federal taxable income. Out of almost 80,000 returns, 33% were taxable returns and 67% were nontaxable returns. Taxable returns with a federal taxable income over $50 million, made up only 2% of the returns but accounted for 85% of the federal taxable income before NOL and 54% of the tax liability.

Of the 43,001 returns with federal taxable income of zero or less, 1,579 had a North Carolina tax liability as a result of adjustment to income or the allocation of nonapportionable income to North Carolina. Of the remaining 36,895 returns that did show a federal taxable income, 12,089 did not have a net North Carolina liability. Within this group, 2,748 did not apportion any income to North Carolina. Of those apportioning income to North Carolina, 8,504 did not have any tax liability because their taxable income was reduced to zero as a result of deductions for Net Economic Loss.

Table 2.7
C-Corporation Income Tax Calculation Detail by Federal Taxable Income (Before NOL)
Tax Year 2003

FTI of Corporation	Number of Returns	Federal Taxable Income, Before NOL [$]	(+) Adjustments to Federal Income [$]	(-) Contributions to Donees Outside NC [$]	(-) Nonapportionable Income [$]	(-) Reduction Due To Apportionment [$]	(=) Income Apportioned to NC [$]
Taxable Returns							
$0 or less	1,579	(8,706,439,441)	16,123,473,100	140,934,456	54,254,054	6,734,634,523	487,294,072
$1-$20,000	10,174	61,248,801	77,560,552	2,836,722	619,040	62,285,748	73,067,895
$20,001-$100,000	5,930	283,573,230	188,958,827	1,499,831	3,121,482	198,004,025	269,902,676
$100,001-$1,000,000	3,982	1,413,524,602	446,949,426	9,443,617	20,444,950	1,139,282,217	691,303,244
$1,000,001-$10,000,000	2,849	10,624,921,560	2,846,820,476	58,183,921	73,398,505	11,611,211,776	1,728,947,826
$10,000,001-$50,000,000	1,275	28,500,065,880	6,318,189,901	171,532,810	207,263,879	32,206,611,889	2,232,847,151
$50,000,001+	596	178,826,483,614	10,002,456,914	1,335,011,861	2,529,774,516	178,593,454,825	6,370,699,408
Total, Taxable	26,385	211,003,378,246	36,004,409,196	1,719,443,218	2,888,876,426	230,545,485,003	11,854,062,272
Nontaxable Returns							
$0 or less	41,422	(268,641,610,548)	16,918,078,007	43,887,724	1,672,093,643	(242,199,472,133)	(11,047,857,560)
More than $0	12,089	82,751,650,316	(18,809,297,677)	341,198,215	1,984,441,576	60,029,638,984	1,477,955,238
Total, Nontaxable	53,511	(185,889,960,232)	(1,891,219,670)	385,085,939	3,656,535,219	(182,169,833,149)	(9,569,902,322)

FTI of Corporation	Income Apportioned to NC [$]	(+) Nonapportonable Income Allocated to NC [$]	(-) Percentage Depletion Over Cost Depletion [$]	(-) Net Economic Loss [$]	(-) Contributions to NC Donees [$]	(=) Net Taxable Income [$]	(6.9%) Computed Income Tax [$]	(-) Tax Credits [$]	(=) Net Tax Liability * [$]
Taxable Returns									
$0 or less	487,294,072	4,136,771	12,917,297	7,847,855	1,416,207	469,287,300	32,380,852	4,347,392	28,033,460
$1-$20,000	73,067,895	302,511	13,652	6,065,547	744,704	66,547,889	4,591,908	257,197	4,334,711
$20,001-$100,000	269,902,676	1,062,930	-	23,189,051	2,348,027	245,427,628	16,933,272	961,274	15,971,998
$100,001-$1,000,000	691,303,244	7,826,160	1,637	53,144,791	4,565,296	641,417,680	44,257,813	1,873,562	42,384,252
$1,000,001-$10,000,000	1,728,947,826	6,500,766	2,094,045	110,935,271	8,124,429	1,614,294,847	111,386,341	6,224,838	105,161,503
$10,000,001-$50,000,000	2,232,847,151	44,832,714	294,005	134,833,028	10,711,184	2,131,841,648	147,097,080	9,959,680	137,137,400
$50,000,001+	6,370,699,408	(16,252,267)	7,878,190	120,639,916	45,279,173	6,180,651,933	426,464,988	32,547,047	393,917,941
Total, Taxable	11,854,062,272	48,409,585	23,198,826	456,655,459	73,189,020	11,349,468,925	783,112,254	56,170,990	726,941,265
Nontaxable Returns									
$0 or less	(11,047,857,560)	(36,863,289)	25,753,271	9,824,672,501	4,849,160	(20,939,943,176)	813	813	-
More than $0	1,477,955,238	(10,178)	15,816,097	5,843,858,813	37,202,976	(4,416,925,386)	8,945	8,945	-
Total, Nontaxable	(9,569,902,322)	(36,873,467)	41,569,368	15,668,531,314	42,052,136	(25,356,868,562)	9,758	9,758	-

* Net tax liability is prior to the application of the refundable credit in G.S. 105-129.28. Because this credit is limited to a very small number of taxpayers, including its effects would violate taxpayer confidentiality.

Note: Figures are based on both audited and unaudited returns. Detail may not add to totals due to rounding or taxpayer error.

Table 2.8 and 2.9 show the distribution of taxable returns and income tax credits taken by tax credit as a percent of tax and federal taxable income. Ninety-five percent of the returns did not take any income tax credit. Forty-three percent of the returns taking credits had over 40% of their tax relieved by the income tax credits. These returns accounted for 37% of the total credits taken.

Table 2.8
C-Corporation Returns by Income Tax Credits as a Percentage of Tax
Tax Year 2003

Federal Taxable Income	Income Tax Credits as a Percentage of Tax						
	0%	0%-4.9%	5%-9.9%	10%-19.9%	20%-39.9%	40%+	Total
$0 or less	42,729	19	12	18	24	199	43,001
$1 - $20,000	14,749	79	48	89	126	712	15,803
$20,001- $100,000	7,300	237	166	203	206	411	8,523
$100,001 - $ 1,000,000	5,242	227	131	109	79	100	5,888
$1,000,001 - $10,000,000	3,895	101	31	22	24	67	4,140
$10,000,001-$35,000,000	1,606	25	10	25	14	36	1,716
$50,000,001+	754	22	7	9	11	22	825
Total	76,275	710	405	475	484	1,547	79,896

Note: The table does not include the refundable credit in G.S. 105-129.28. Because this credit is limited to a very small number of taxpayers, including its effects would violate taxpayer confidentiality. Figures are based on both audited and unaudited returns.

Table 2.9
C-Corporation Tax Credits for Taxable Returns Income Tax Credits as a Percentage of Tax
Tax Year 2003

Federal Taxable Income	Income Tax Credits as a Percentage of Tax						
	0% [$]	0%-4.9% [$]	5%-9.9% [$]	10%-19.9% [$]	20%-39.9% [$]	40%+ [$]	Total [$]
$0 or less	-	20,929	943,227	15,990	658,695	2,709,364	4,348,205
$1 - $20,000	-	1,672	3,793	15,350	40,428	196,680	257,923
$20,001- $100,000	-	26,285	54,309	150,182	237,355	501,362	969,493
$100,001 - $ 1,000,000	-	142,342	182,419	214,887	325,057	1,008,857	1,873,562
$1,000,001 - $10,000,000	-	192,305	338,322	261,884	863,300	4,569,027	6,224,838
$10,000,001-$35,000,000	-	235,916	176,001	1,946,363	1,561,663	6,039,737	9,959,680
$50,000,001+	-	543,646	2,235,935	7,839,656	15,682,005	6,245,805	32,547,047
Total		1,163,095	3,934,006	10,444,312	19,368,503	21,270,832	56,180,748

Note: The table does not include the refundable credit in G.S. 105-129.28. Because this credit is limited to a very small number of taxpayers, including its effects would violate taxpayer confidentiality. Figures are based on both audited and unaudited returns.

Figure 2.10 shows income tax credits by federal taxable income for North Carolina taxable returns. Corporations with federal taxable income over $50 million took over half of the tax credits.

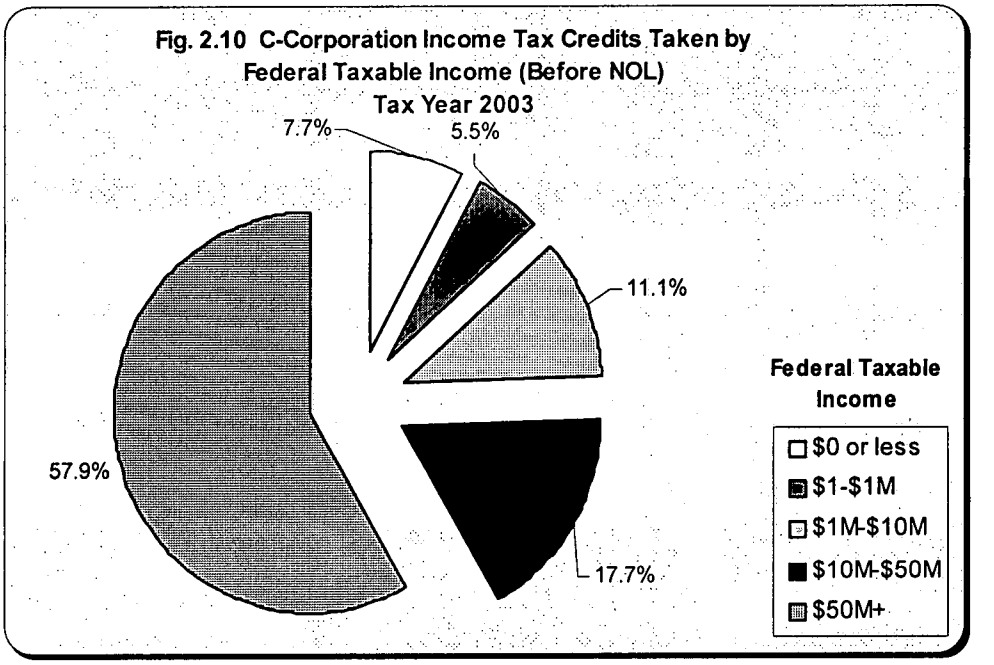


Table 2.11 provides the distribution of income tax credits by credit type and federal taxable income. Corporations with federal taxable income over $1 million took 90% of the credits. The most claimed credits were in the category, Lee Act and Other Limited Credits.

Table 2.11
C-Corporation Income Tax Credits by Credit Type and Federal Taxable Income (Before NOL)
Tax Year 2003

	All Returns		FTI <$1,000,001		FTI $1,000,001+	
Income Tax Credits	Number of Credits *	Amount Claimed ($)	Number of Credits	Amount Claimed ($)	Number of Credits	Amount Claimed ($)
Rehabilitating a Historic Structure	16	3,148,940	6	239,487	10	2,909,453
Savings and Loan Supervisory Fees	14	157,804	6	19,218	8	138,586
Carryover from Previous Years Credits	8	1,757,168	5	487,896	3	1,269,272
Lee Act and Other Limited Credits	3,565	48,882,783	3,159	5,162,134	406	43,720,649
Others **	37	8,370,470	25	2,747,386	12	5,623,084
Credits Claimed ***	3,640	62,317,165	3,201	8,656,121	439	53,661,044
Credits Not Taken ****	--	6,136,417	--	3,080,500	--	3,055,917
Credits Taken ***	--	56,180,748	--	5,575,621	--	50,605,127

* The total number of credits does not equal to the total number of returns claiming credits stated in Table 2.7 and 2.8.
** This category includes Certain Real Property Donation, Reinvestments by Major Recycling Facilities, and Other Non-Limited Credits.
*** The credit is greater than the amount stated due to the refundable credit in G.S. 105-129.28. Because this credit is limited to a very small number of taxpayers, including its effects would violate taxpayer confidentiality.
**** Credits were not taken against tax because taxpayer's liability was less than the amount of credits claimed or because of taxpayer error.

Note: Figures are based on both audited and unaudited returns. Detail may not add to totals due to rounding or taxpayer error.

S-CORPORATIONS

S-Corporations pass their income tax liability along to shareholders, who pay tax on the income according to the individual income tax rate schedule. S-Corporations that have shareholders who are not North Carolina residents may pass the tax liability to those shareholders only if the nonresidents sign an agreement to pay North Carolina taxes on their share of the corporation's income. For nonresident shareholders who fail to sign such an agreement, the S-corporations must file a composite return and pay the tax for the shareholders. The tax for nonresidents filing composite is calculated according to the individual income tax rate schedule, but the collections are considered corporate income tax receipts.

Table 2.12
S-Corporation Returns and Net Income Tax Liability by NC Taxable Income
Tax Year 2003

NC Taxable Income	Number of Returns	Percent	Number With Tax Due for Nonresidents	Net Tax Liability [$]	Percent
$0 or less*	45,450	41.14%	23	11,531	0.03%
$1-$15,000	23,300	21.09%	1,616	411,971	1.10%
$15,001-30,000	11,113	10.06%	431	508,839	1.36%
$30,001-$50,000	8,591	7.78%	291	607,737	1.63%
$50,001-$100,000	9,857	8.92%	378	1,486,371	3.98%
$100,001-$500,000	9,956	9.01%	552	6,805,245	18.22%
$500,001-$1,000,000	1,217	1.10%	107	4,623,761	12.38%
$1,000,001+	990	0.90%	110	22,900,120	61.30%
Total	110,474	100.00%	3,508	37,355,575	100.00%

* Includes both returns with no Federal Taxable Income and those that have Federal Taxable Income but no North Carolina Taxable Income. The Net Tax Liability in this bracket is positive due to taxpayer error.

Note: Figures are based on both audited and unaudited returns. Detail may not add to totals due to rounding or taxpayer error.

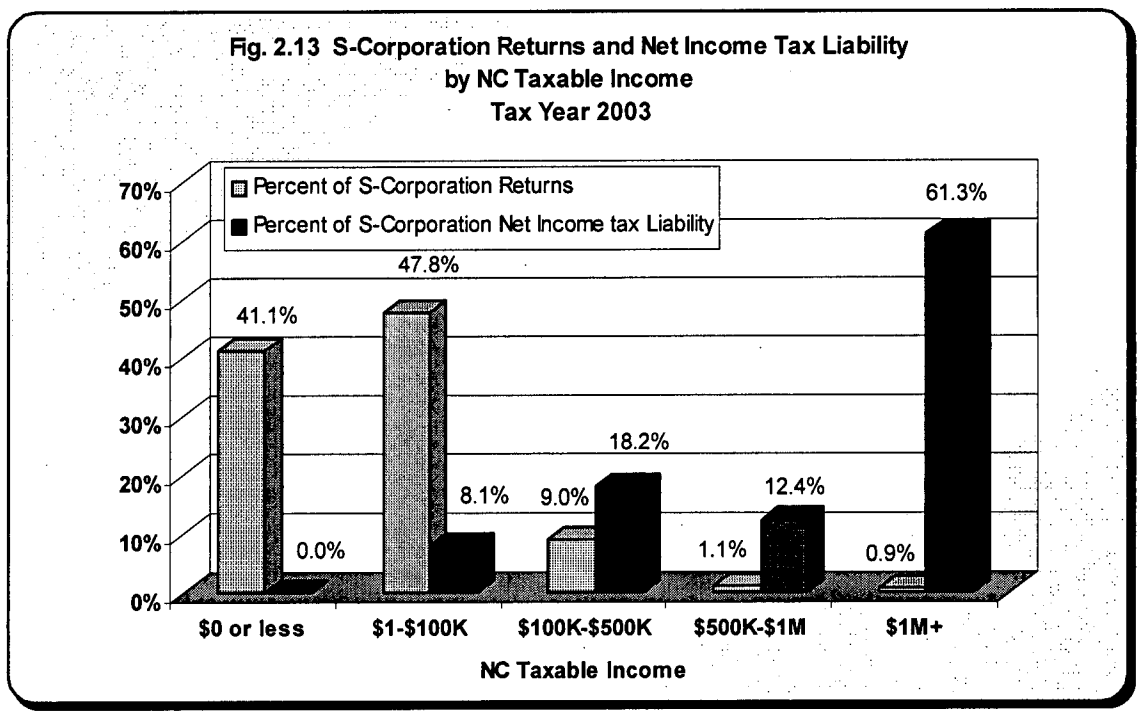


Table 2.12 and Figure 2.13 show the number of returns and net income tax liability by North Carolina taxable income. Corporations with taxable income of $1 million or more accounted for over 60% of the tax liability.

Figure 2.14 shows the distribution of returns by North Carolina taxable income and nonresident shareholder filing status. Only 3.2% of S-corporation returns had a tax liability attributable to nonresidents.

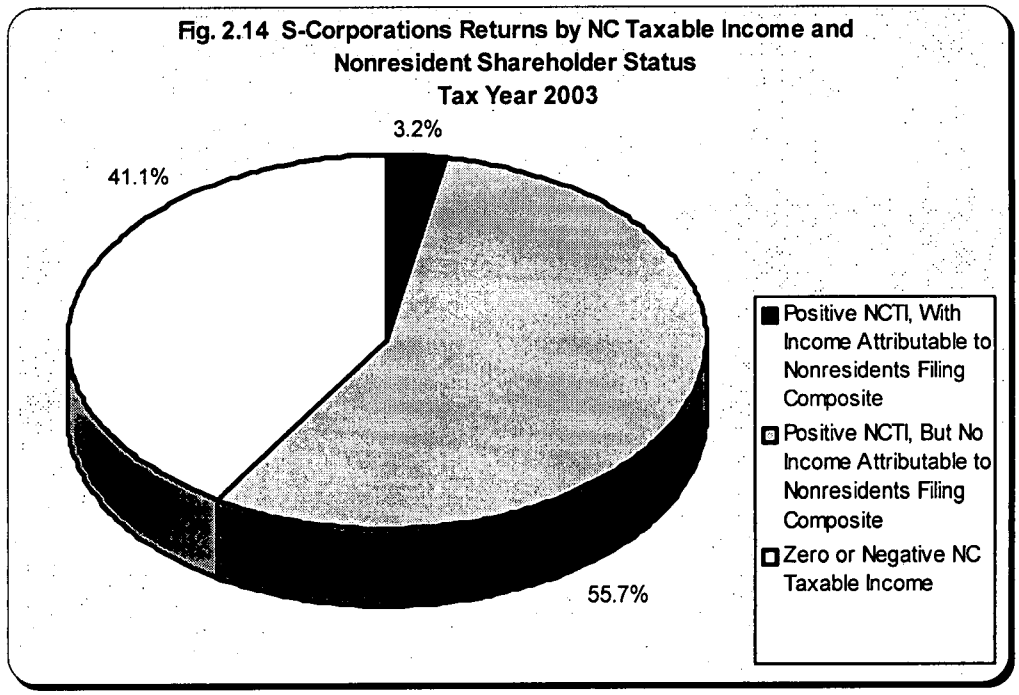


Table 2.15
S-Corporation Income Tax Calculation Detail
Tax Year 2003

NC Taxable Income	Number of Returns	(+) Corporation Income [$]	(+) Adjustments to Federal Income [$]	(-) Nonapportionable Income [$]	(-) Reduction Due To Apportionment [$]	(=) Income Apportioned to NC [$]
Taxable Returns						
Zero or Negative	45,427	(1,902,251,275)	191,508,959	307,288,067	(1,528,516,334)	(1,820,246,658)
Positive, But No Income Attributable to Nonresidents Filing Composite	61,539	14,564,213,202	701,029,433	364,995,083	8,313,722,197	6,579,440,435
Positive, With Income Attributable to Nonresidents Filing Composite	3,508	13,821,049,495	836,803,186	1,186,417,510	12,773,874,599	585,115,818
Total	110,474	26,483,011,422	1,729,341,578	1,858,700,660	19,559,080,462	5,344,309,595

NC Taxable Income	(+) Nonapportionable Income Allocated to NC [$]	(-) Percentage Depletion Over Cost Depletion [$]	(=) Net Taxable Income [$]	(+) Adjustment for Shareholders Paying Tax on Shares Income [$]	(=) Taxable Income Attributable to Nonresidents Filing Composite [$]	(Tax Rates%) Computed Net Income Tax [$]	(-) Tax Credits [$]	(=) Net Tax Liability [$]
Taxable Returns								
Zero or Negative*	(2,890,916)	412,197,168	(2,314,304,751)	2,261,491,606	(52,813,145)	1,241	-	1,241
Positive, But No Income Attributable to Nonresidents Filing Composite*	62,006,600	101,328	6,641,387,063	(6,641,442,179)	(55,116)	34,923	-	34,743
Positive, With Income Attributable to Nonresidents Filing Composite	12,666,604	39	597,768,705	(93,268,904)	504,499,801	37,780,429	460,838	37,319,591
Total	71,782,288	412,298,535	4,924,851,017	(4,473,219,477)	451,631,540	37,816,593	460,838	37,355,575

* The computed Net Income and Net Tax Liability in these categories are positive due to taxpayer error.

Note: Figures are based on both audited and unaudited returns. Detail may not add to totals due to rounding or taxpayer error.

Table 2.16 shows the income tax credits by credit type and taxable income. Corporations with taxable income over $500,000 took 77% of the credits.

Table 2.16
S-Corporation Income Tax Credits by Credit Type and Taxable Income
Tax Year 2003

Income Tax Credits	All Returns		Taxable Income <$500,001		Taxable Income $500,001+	
	Number of Credits *	Amount Claimed ($)	Number of Credits	Amount Claimed ($)	Number of Credits	Amount Claimed ($)
Lee Act and Other Limited Credits	242	539,051	147	70,785	95	468,266
Others **	30	49,291	21	21,007	9	28,284
Credits Claimed	272	588,342	168	91,792	104	496,550
Credits Not Taken ***	--	127,504	--	(14,656)	--	142,160
Credits Taken	--	460,838	--	106,448	--	354,390

* The total number of credits does not equal to the total number of returns claiming credits stated in Table 2.7.

** This category includes Rehabilitating a Historic Structure, Certain Real Property Donation, Savings and Loan Supervisory Fees, Other Non-Limited Credits, Carryover from Previous Years Credits, and Reinvestments by Major Recycling Facilities credits.

*** Credits were not taken against tax because taxpayer's liability was less than the amount of credits claimed or because of taxpayer error.

Note: Total numbers of credits are unavailable for Credits Not Taken and for Credits Taken. Confidentiality prevents the disclosure of the individual credits and credits amount. Figures are based on unaudited returns. Detail may not add to totals due to rounding or taxpayer error.

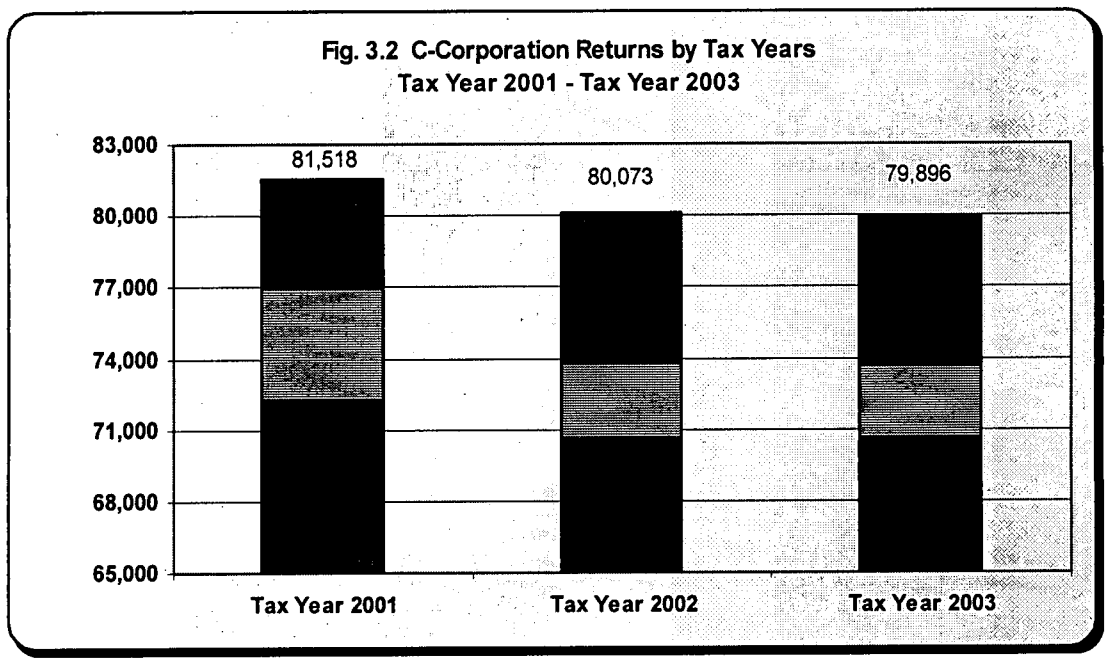
C-CORPORATIONS

Table 3.1, Figure 3.2 and Figure 3.3 compare the number of returns by tax years. In 2002, the number of returns decreased by 1,445, and in 2003, it decreased by 177 returns. These decreases were due to conversions of C-corporations to S-corporations, which offset growth in the number of C-corporations. In 2002, 1,990 C-corporations converted to S-corporations, and in 2003, 1,932 C-corporations converted.

Table 3.1
C-Corporation Returns by NC Taxable Income
Tax Year 2001 – Tax Year 2003

NC Taxable Income	Number of Returns TY 2001	Number of Returns TY 2002	% Change	Number of Returns TY 2003	% Change
$0 or less	53,559	53,515	-0.08%	53,308	-0.39%
$1-$15,000	14,059	13,193	-6.16%	13,397	1.55%
$15,001-$30,000	3,392	3,275	-3.45%	3,156	-3.63%
$30,001-$50,000	2,540	2,369	-6.73%	2,256	-4.77%
$50,001-$100,000	2,829	2,608	-7.81%	2,517	-3.49%
$100,001-$500,000	3,257	3,158	-3.04%	3,218	1.90%
$500,001-$1,000,000	733	744	1.50%	739	-0.67%
$1,000,001-$10,000,000	997	1,053	5.62%	1,151	9.31%
$10,000,001+	152	158	3.95%	154	-2.53%
Total	81,518	80,073	-1.77%	79,896	-0.22%

Note: Figures are based on both audited and unaudited returns. Detail may not add to totals due to rounding or taxpayer error.



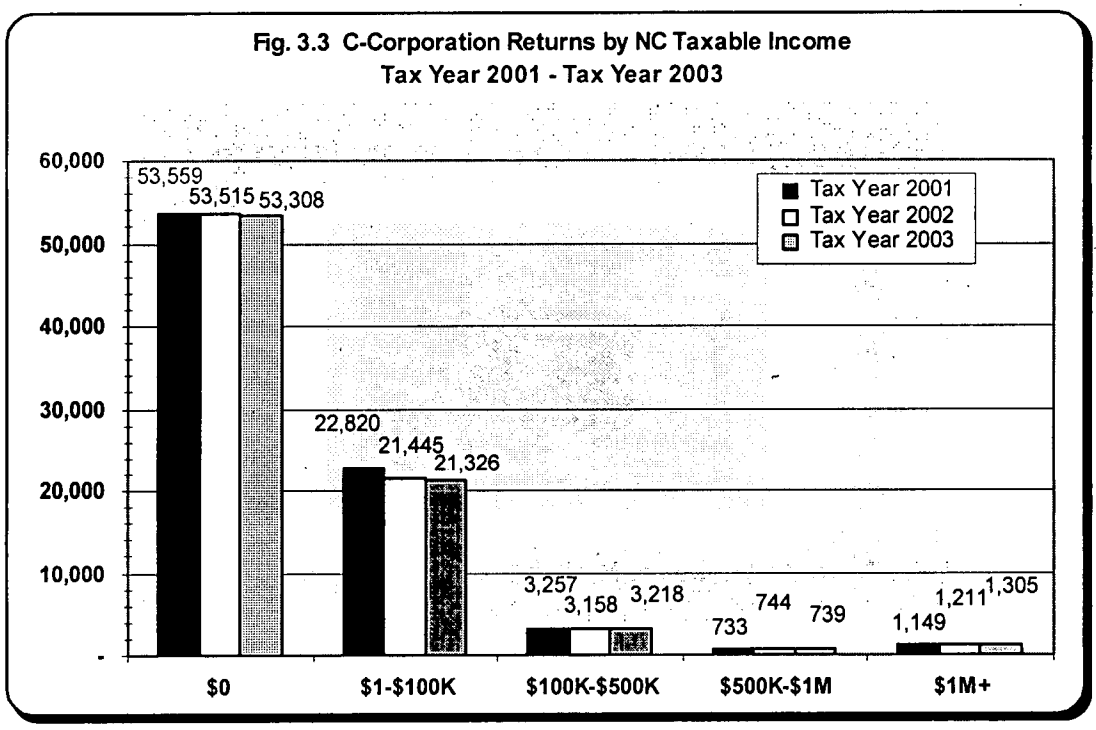


Table 3.4 and Figure 3.5 show the net income tax liability by North Carolina taxable income. In 2002, the liability increased by $40 million, and in 2003, it declined by $9 million. This trend was the result of a one year $36 million spike in the tax liability of returns with NC taxable income of over $10 million, and growth in the liability of returns with taxable income between $1 million and $10 million. Within the highest income group, the spike in tax liability was attributable largely to a single multi-state corporation that realized a significant capital gain during 2002.

Table 3.4
C-Corporation Net Income Tax Liability by NC Taxable Income
Tax Year 2001 – Tax Year 2003

NC Taxable Income	Net Income Tax Liability * TY 2001	Net Income Tax Liability * TY 2002	% Change	Net Income Tax Liability * TY 2003	% Change
$0 or less	--	--	--	--	--
$1-$15,000	3,964,846	3,833,480	-3.31%	3,776,491	-1.49%
$15,001-$30,000	4,784,904	4,611,579	-3.62%	4,519,503	-2.00%
$30,001-$50,000	6,430,697	6,032,744	-6.19%	5,788,197	-4.05%
$50,001-$100,000	12,813,774	11,894,096	-7.18%	11,676,194	-1.83%
$100,001-$500,000	47,407,894	46,160,786	-2.63%	48,488,171	5.04%
$500,001-$1,000,000	34,698,782	35,054,191	1.02%	35,376,798	0.92%
$1,000,001-$10,000,000	185,023,140	191,705,268	3.61%	215,641,627	12.49%
$10,000,001+	401,098,604	437,518,061	9.08%	401,674,284	-8.19%
Total	696,222,641	736,810,205	5.83%	726,941,265	-1.34%

* Net tax liability is prior to the application of the refundable credit in G.S. 105-129.28. Because this credit is limited to a very small number of taxpayers, including its effects would violate taxpayer confidentiality.

Note: Figures are based on both audited and unaudited returns. Detail may not add to totals due to rounding or taxpayer error.

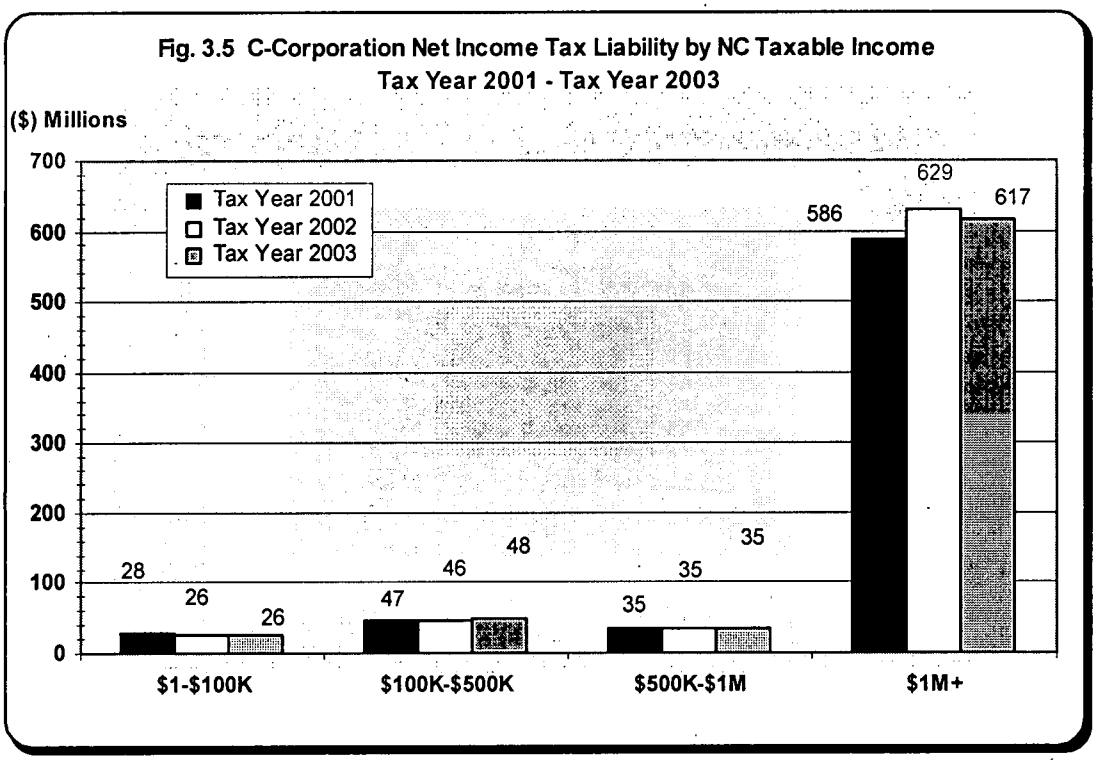


Table 3.6 shows the tax credits by credit type. In 2002, credits increased by $6 million due largely to increased use of the Lee Act credits by a small number of taxpayers.

Table 3.6
C-Corporation Income Tax Credits by Credit Type
Tax Year 2001 – Tax Year 2003

Income Tax Credits	Tax Year 2001 Number of Credits	Tax Year 2001 Amount Claimed ($)	Tax Year 2002 Number of Credits	Tax Year 2002 Amount Claimed ($)	Tax Year 2003 Number of Credits	Tax Year 2003 Amount Claimed ($)
Rehabilitating a Historic Structure	13	3,034,512	21	4,623,755	16	3,148,940
Savings and Loan Supervisory Fees	13	277,090	20	218,440	14	157,804
Carryover from Previous Years Credits	15	490,205	18	1,418,388	8	1,757,168
Lee Act and Other Limited Credits	4,967	45,065,260	4,270	60,893,338	3,565	48,882,783
Others *	33	4,047,421	54	4,978,747	37	8,370,470
Credits Claimed **	5,041	52,914,488	4,383	72,132,668	3,640	62,317,165
Credits Not Taken ***	--	3,955,026	--	16,306,663	--	6,136,426
Credits Taken *	--	48,959,462	--	55,826,005	--	56,180,748

* This category includes Certain Real Property Donation, Reinvestments by Major Recycling Facilities and Other Non-Limited Credits.
** The credit is greater than the amount stated due to the refundable credit in G.S. 105-129.28. Because this credit is limited to a very small number of taxpayers, including its effects would violate taxpayer confidentiality.
*** Credits were not taken against tax because taxpayer's liability was less than the amount of credits claimed or because of taxpayer error.

Note: Figures are based on both audited and unaudited returns. Detail may not add to totals due to rounding or taxpayer error.

Tables 3.7 and 3.8 show the number of returns and credits by the percentage of income tax relieved by income tax credits. Less than one-fifth of the returns with a tax liability made use of available tax credits. The majority of these reduced their tax by at least 40% through use of tax credits.

Table 3.7
C-Corporation Returns by Percentage of Income Tax Relieved by Income Tax Credits
Tax Year 2001 – Tax Year 2003

% of Tax Relieved by Credits	Number of Taxpayers TY 2001	Number of Taxpayers TY 2002	Number of Taxpayers TY 2003
0%	76,503	75,760	76,275
0 - 4.9 %	905	755	710
5 - 9.9 %	566	502	405
10 - 19.9 %	721	585	475
20 - 39.9 %	776	652	484
40 % +	2,047	1,819	1,547
Total	81,518	80,073	79,896

Note: Figures are based on both audited and unaudited returns. Detail may not add to totals due to rounding or taxpayer error.

Table 3.8
C-Corporation Credits by Percentage of Income Tax Relieved by Income Tax Credits *
Tax Year 2001 – Tax Year 2003

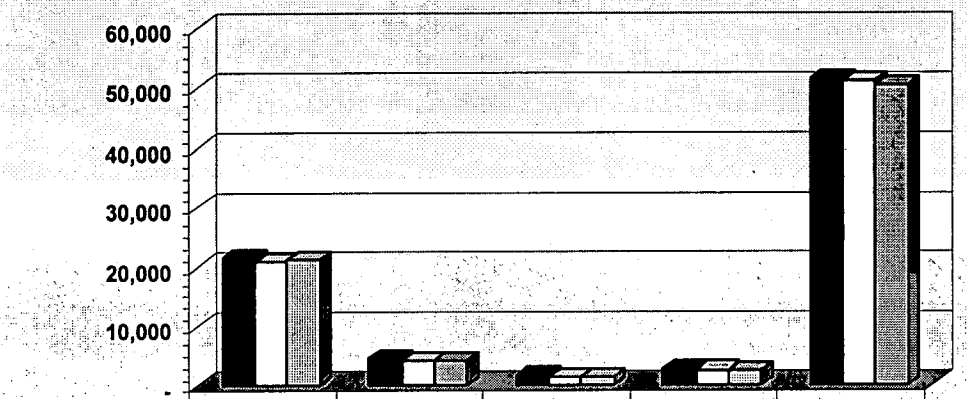
% of Tax Relieved by Credits	Amount of Tax Relieved TY 2001	Amount of Tax Relieved TY 2002	Amount of Tax Relieved TY 2003
0%	-	-	-
0 - 4.9 %	2,349,558	2,374,899	1,163,095
5 - 9.9 %	3,398,659	3,443,826	3,934,006
10 - 19.9 %	16,929,489	6,330,879	10,444,312
20 - 39.9 %	6,138,221	24,870,686	19,368,503
40 % +	20,143,535	18,805,715	21,270,832
Total	48,959,462	55,826,005	56,180,748

* Net tax liability is prior to the application of the refundable credit in G.S. 105-129.28. Because this credit is limited to a very small number of taxpayers, including its effects would violate taxpayer confidentiality.

Note: Figures are based on both audited and unaudited returns. Detail may not add to totals due to rounding or taxpayer error.

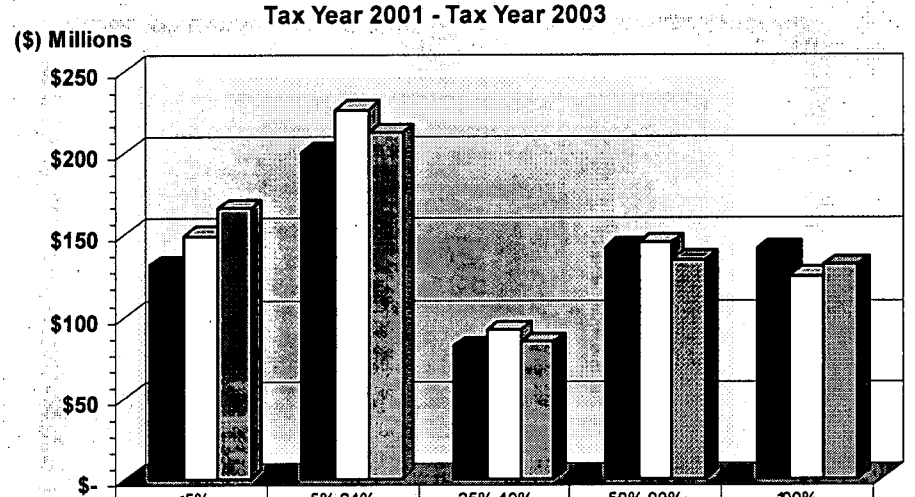
Figures 3.9 and 3.10 show the distribution of returns and net income tax liability by apportionment percentage. The distribution of returns for all categories were fairly similar in all tax years, but the portion of the tax liability attributable to corporations apportioning less than 5% of their income to North Carolina has increased.

Fig. 3.9 C-Corporation Returns by Apportionment Percentage
Tax Year 2001 - Tax Year 2003



	<5%	5%-24%	25%-49%	50%-99%	100%
Tax Year 2001	21,383	4,379	1,585	2,688	51,483
Tax Year 2002	20,763	4,087	1,534	2,610	51,079
Tax Year 2003	21,227	4,089	1,550	2,539	50,491

Fig. 3.10 C-Corporation Net Income Tax Liability
by Apportionment Percentage
Tax Year 2001 - Tax Year 2003



	<5%	5%-24%	25%-49%	50%-99%	100%
Tax Year 2001	$131,033,310	$200,301,143	$81,586,977	$142,010,800	$141,290,411
Tax Year 2002	$149,307,536	$226,453,355	$91,758,250	$144,720,469	$124,570,596
Tax Year 2003	$166,352,919	$211,632,003	$84,002,257	$134,118,113	$130,835,973

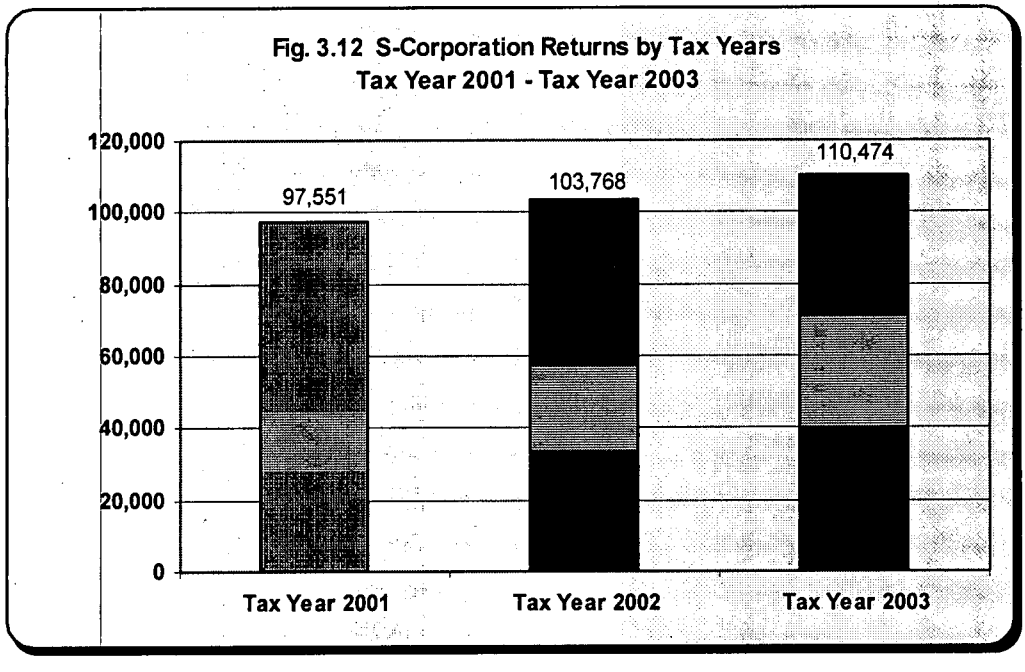
S-CORPORATIONS

Table 3.11, Figure 3.12, and Figure 3.13 compare the number of returns by tax years. In 2002, the number of returns increased by 6,217, and in 2003, it increased by 6,706. In 2002, 1,990 C-corporations converted to S-corporations, and in 2003, 1,932 C-corporations converted.

Table 3.11
S-Corporation Returns by NC Taxable Income
Tax Year 2001 – Tax Year 2003

NC Taxable Income	Number of Returns TY 2001	Number of Returns TY 2002	% Change	Number of Returns TY 2003	% Change
$0 or less	41,432	43,360	4.65%	45,450	4.82%
$1-$15,000	19,983	21,689	8.54%	23,300	7.43%
$15,001-$30,000	9,749	10,401	6.69%	11,113	6.85%
$30,001-$50,000	7,564	8,210	8.54%	8,591	4.64%
$50,001-$100,000	8,454	9,019	6.68%	9,857	9.29%
$100,001-$500,000	8,509	9,066	6.55%	9,956	9.82%
$500,001-$1,000,000	1,072	1,169	9.05%	1,217	4.11%
$1,000,001+	788	854	8.38%	990	15.93%
Total	97,551	103,768	6.37%	110,474	6.46%

Note: Figures are based on both audited and unaudited returns. Detail may not add to totals due to rounding or taxpayer error.



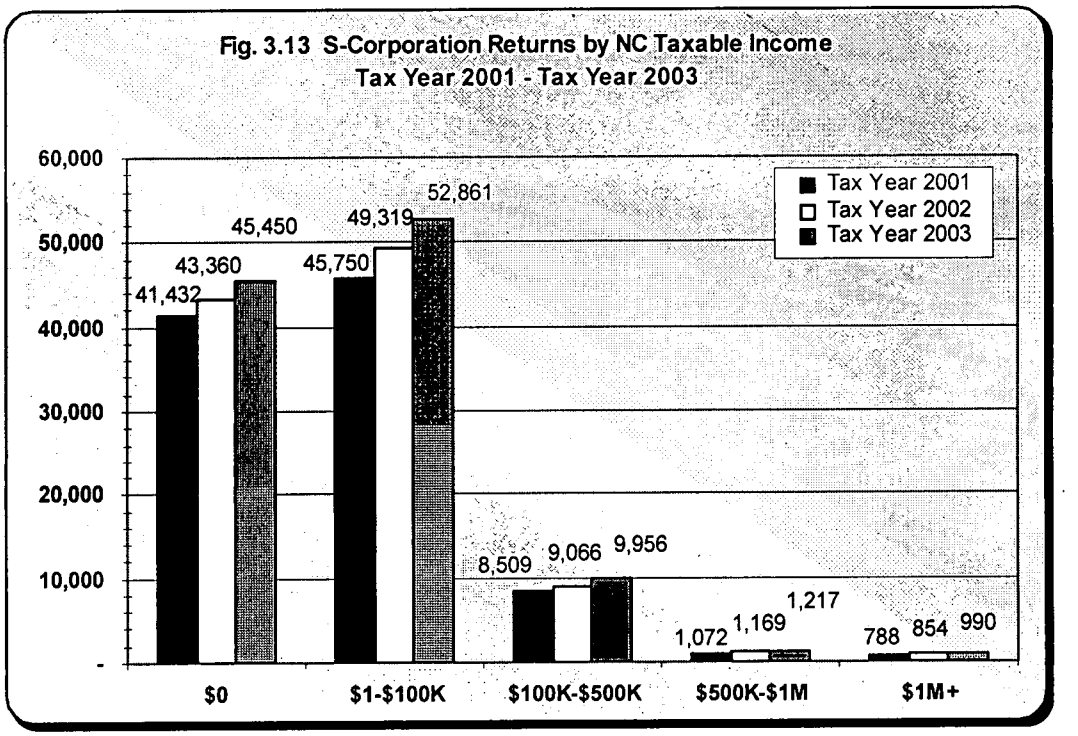


Table 3.14 and Figure 3.15 show the net income tax liability by taxable income. In 2002, the liability increased by $5 million, and in 2003, it increased by $8 million. The increase was due almost entirely to higher taxes paid for nonresident shareholders of corporations with taxable income over $1 million.

Table 3.14
S-Corporation Net Income Tax Liability by NC Taxable Income
Tax Year 2001 – Tax Year 2003

NC Taxable Income	Net Income Tax Liability TY 2001	Net Income Tax Liability TY 2002	% Change	Net Income Tax Liability TY 2003	% Change
$0 or less	3,787	7,240	91.18%	11,531	59.27%
$1-$15,000	380,158	390,908	2.83%	411,971	5.39%
$15,001-$30,000	415,316	459,594	10.66%	508,839	10.71%
$30,001-$50,000	548,170	640,279	16.80%	607,737	-5.08%
$50,001-$100,000	1,220,923	1,427,036	16.88%	1,486,371	4.16%
$100,001-$500,000	6,526,510	6,725,469	3.05%	6,805,245	1.19%
$500,001-$1,000,000	4,038,374	4,883,568	20.93%	4,623,761	-5.32%
$1,000,001+	10,087,916	14,167,431	40.44%	22,900,120	61.64%
Total	23,221,154	28,701,525	23.60%	37,355,575	30.15%

Note: Figures are based on both audited and unaudited returns. Detail may not add to totals due to rounding or taxpayer error.

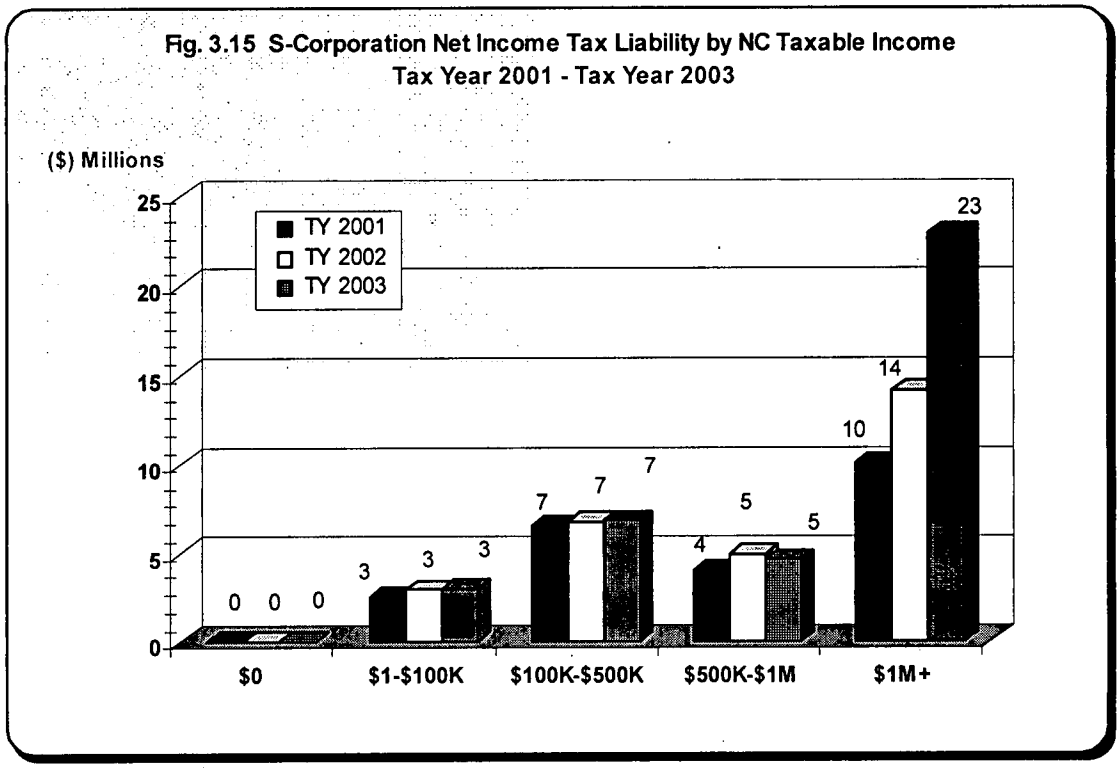
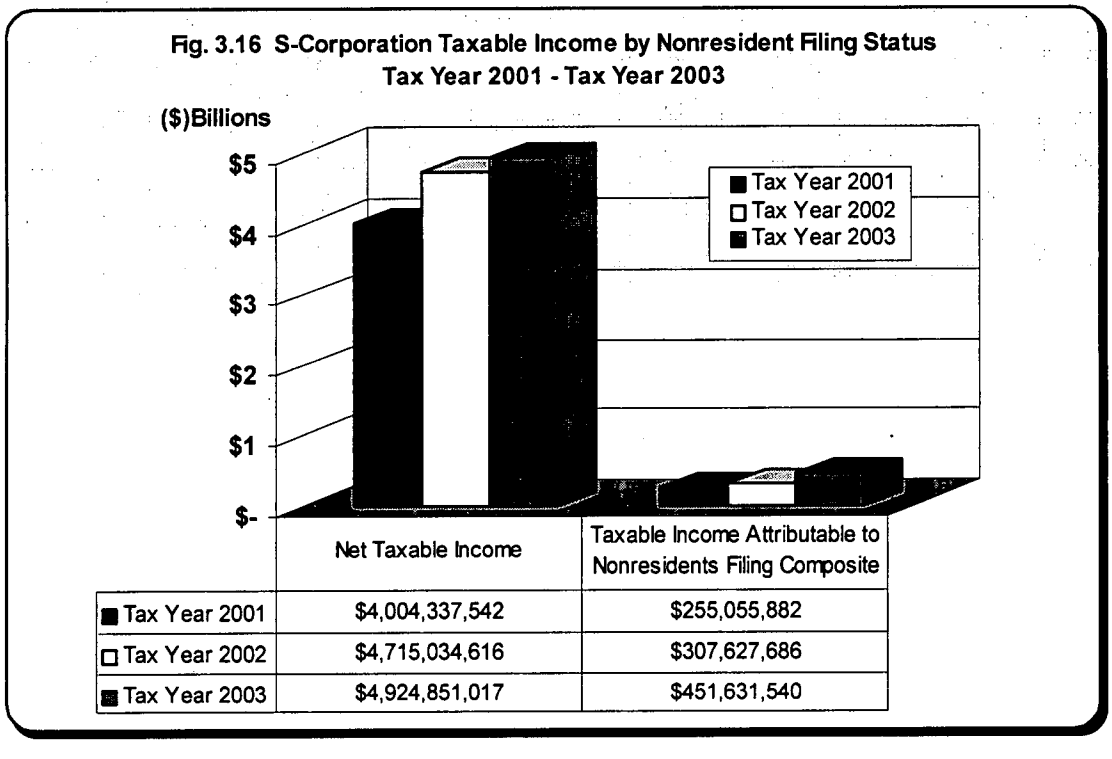


Figure 3.16 shows the net taxable income and taxable income attributable to nonresidents filing composite. There was an increase in the net taxable income and in the nonresident taxable income for all three tax years.



	Net Taxable Income	Taxable Income Attributable to Nonresidents Filing Composite
Tax Year 2001	$4,004,337,542	$255,055,882
Tax Year 2002	$4,715,034,616	$307,627,686
Tax Year 2003	$4,924,851,017	$451,631,540

Table 3.17 shows the income tax credits by credit type for three tax years. In 2002, the credits taken increased by $107,000, and in 2003, it increased by $60,000. The most claimed credits were in the category, Lee Act and Other Limited Credits for all tax years.

Table 3.17
S-Corporation Income Tax Credits by Credit Type
Tax Year 2001 – Tax Year 2003

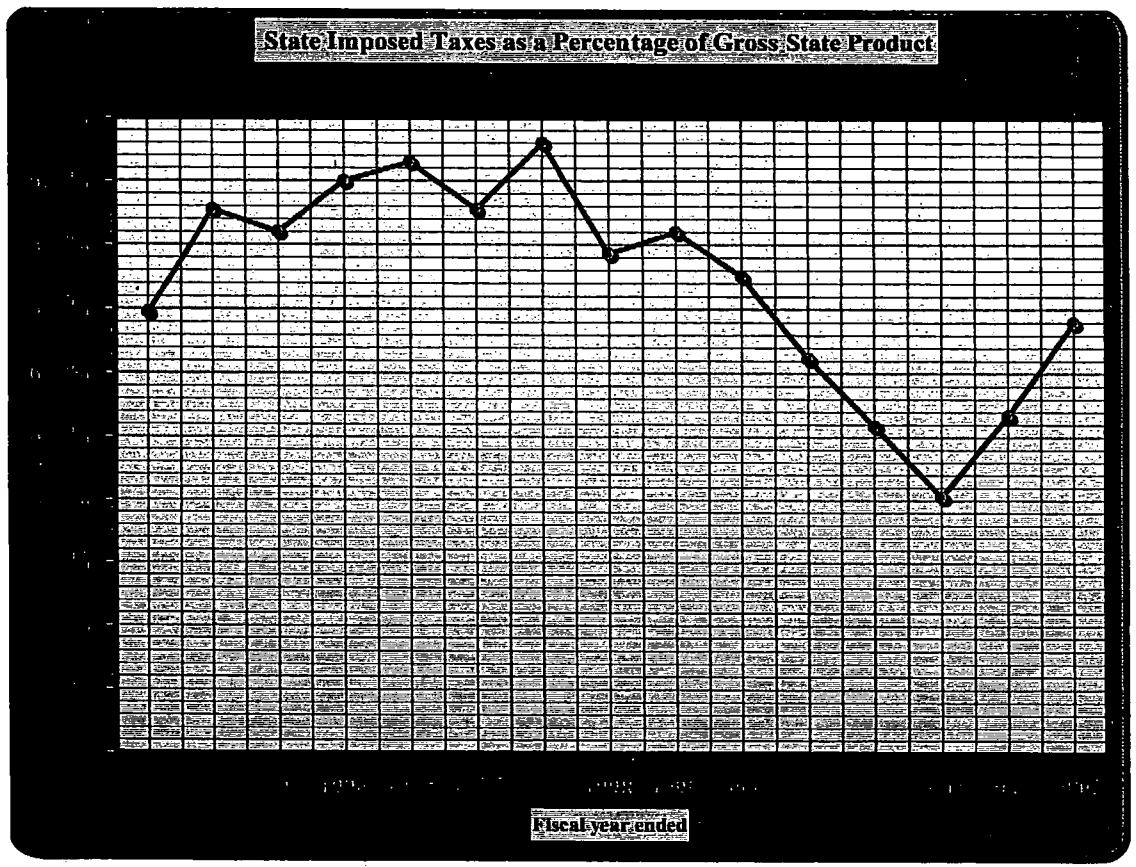
Income Tax Credits	Tax Year 2001 Number of Credits	Tax Year 2001 Amount Claimed ($)	Tax Year 2002 Number of Credits	Tax Year 2002 Amount Claimed ($)	Tax Year 2003 Number of Credits	Tax Year 2003 Amount Claimed ($)
Carryover from Previous Years Credits	-	-	12	5,118	12	11,426
Lee Act and Other Limited Credits	144	289,410	330	574,716	245	539,054
Others *	4	26,923	27	101,241	34	37,989
Credits Claimed	148	316,333	369	681,075	291	588,469
Credits Not Taken **	--	23,735	--	280,928	--	127,631
Credits Taken	--	292,598	--	400,147	--	460,838

* This category includes Rehabilitating a Historic Structure, Savings and Loan Supervisory Fees, Other Non-Limited Credits, Certain Real Property Donation, and Reinvestments by Major Recycling Facilities credits.

** Credits were not taken against tax because taxpayer's liability was less than the amount of credits claimed or because of taxpayer error.

Note: Figures are based on both audited and unaudited returns. Detail may not add to totals due to rounding or taxpayer error.

Statistical Abstract of North Carolina Taxes
2006

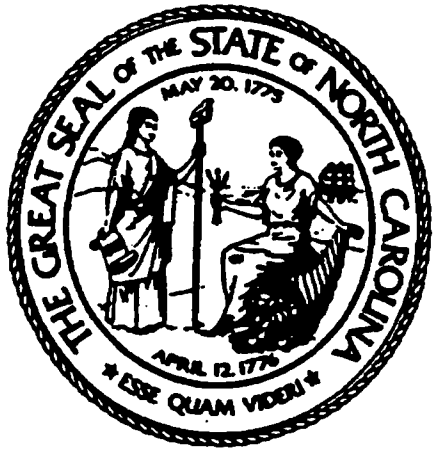


Policy Analysis and Statistics Division

STATE OF NORTH CAROLINA

FINAL REPORT

GOVERNOR'S COMMISSION TO MODERNIZE STATE FINANCES



December 2002

OVERVIEW

In February 2002, Gov. Mike Easley issued an executive order creating the Commission to Modernize State Finances and named Thomas Ross, the executive director of the Z. Smith Reynolds Foundation, as its Chair. The Governor named 15 other North Carolinians with broad expertise to the Commission, which has met monthly since its appointment. The Commission members are listed in one of the appendices.

Governor Easley created the Commission out of a recognition that the state's fiscal system faces long-term challenges. Reform is crucial in order for the state and local governments to be successful at meeting the needs of their citizens. The Commission was charged with the task of modernizing state finances to ensure that the state's revenue system was more stable, fair and sufficient over the long term. Unlike the 2001 Efficiency and Loophole-Closing Commission, the Modernizing State Finances Commission did not have a specific revenue target to achieve. Rather, the Governor sought recommendations and insight as to crucial improvements for the long-term fiscal health of North Carolina.

THE GOALS OF THE COMMISSION

In order to guide its work, the Commission discussed and approved several principles as the goals of the Commission. These goals included:

1. *Equity.* A revenue system that ensures that all taxpayers pay a fair and equitable share of their income and wealth in state and local taxes. Those who benefit from services appropriate for user fees should pay the true cost.

2. *Competitiveness.* A revenue system that ensures that North Carolina remains competitive with other states in tax and revenue policy and promotes long-term, sustainable economic development, job creation and growth.

3. *Sufficiency.* A revenue system that provides enough resources over time to provide essential government services without wide variances from year to year.

4. *Simplicity.* A revenue system that is easier for taxpayers to understand and comply with and for administrators to administer.

5. *Efficiency.* A revenue system that does not interfere unduly with good economic decisionmaking.

6. *Appropriate Federalism.* A revenue system that provides both state and local government with appropriate tools for raising revenue to meet the growing needs of each level of government. The system should include consideration of federal tax policy for simplicity, uniformity and deductibility.

Various members of the Commission noted the tension among these goals.

CURRENT SITUATION

The State-Local Partnership

Due to the wisdom and foresight of Governors and legislators of an earlier generation, North Carolina in 1921-33 committed itself to the state financing of the essential services that all citizens need wherever they live and should not vary substantially in availability and quality from county to county. One consequence of that policy decision is that North Carolina relies more heavily than does almost any other state on state taxpayers to finance roads, schools, corrections, and courts. Because the state does not levy a property tax, income taxes (individual and corporate), franchise taxes, sales taxes, and motor vehicle fuel taxes and fees are relatively higher in North Carolina than they are in many states. Property taxes are correspondingly lower here than in most states, because less reliance is placed on that source than in most states. Therefore, in any comparison of tax burdens from state to state, it is essential that both state and local taxes be combined in order to gain a valid understanding of the subject.

In 1998-99 (the latest year available), North Carolina's state and local tax burden combined ranked 29th in the nation on a per-capita basis and 33rd as a percent of personal income. The state ranks 17th in per capita state taxes and 38th in per capita local taxes. In that year, North Carolina state government levied 71 percent of state-local taxes. Nationally, state governments levy 61 percent of the total. All of our neighboring states require local governments to fund a greater share of the state-local tax burden than our state.

The table below shows the source of major taxes as a percent of total state and local taxes for North Carolina, the Mid Southeast (which includes the four bordering states and Kentucky), and the nation. It shows that North Carolina is more reliant on the income tax, and less reliant on sales and property taxes, than states in the region and the nation as a whole. Nationally, the property tax is the largest major source of state and local taxes and is the most stable tax.

Certain Taxes as a Percent of Total State and Local Taxes,
North Carolina, the Mid-Southeast, and United States, 1998-99 Fiscal Year

	North Carolina	Mid Southeast	United States
Individual Income	32.5%	26.2%	23.2%
Sales and Use	21.7%	26.8%	24.6%
Property	21.5%	24.3%	29.4%
Other	24.3%	22.7%	22.8%
Total	100%	100%	100%

The Current Budget Situation

This report comes in the wake of two successive years of substantial revenue shortfalls. General Fund revenues fell short of projections by almost four percent (or over $500 million) in 2000-01 and an unprecedented $1.55 billion (or almost 11 percent) in 2001-02. This instability provides one reason for the need for reform.

The Necessity of Change

The state's tax code was updated in the 1920's and 1930's, when agriculture and traditional manufacturing dominated the state's economy. Record numbers of local governments had defaulted on their bonds. Property taxes were the primary revenue source for state and local government, and the state faced massive budgetary shortfalls.

Much has changed in the decades since Governors Gardner and Ehringhaus confronted these tough issues. The state's economy has become increasingly service-based, with fully half of consumption from the service sector today. People shop over the Internet, not always at the local store. The manufacturing and agriculture sectors continue to shrink as a share of the state's employment. Once-dominant industries such as apparel manufacturing barely exist in the state any more.

The tax policy changes of the 1920s and 1930s have largely been beneficial. Today, more North Carolina local governments have AAA bond ratings, the highest possible, than in any other state. The state's per-capita income rose from 47 percent of the national average in 1929 to 90 percent of the national average in 2001, and the state has reversed decades of population decline and stagnation as more people choose to live and work in the Tar Heel state.

The expectations of government have changed as well over time. Medicaid, the fastest-growing and second-largest item in the state budget, was not even created until the 1960s. For the first time, North Carolina has eclipsed the national average in terms of the rate of college attendance, as new generations find that postsecondary education is crucial for success in the global economy and older generations find that their workplaces are disappearing and their skills need upgrading. The environment and urban growth management are relatively new concerns for North Carolina.

The late 1990s were an unprecedented good time for state governments across the country, and North Carolina was no exception. The combination of a soaring stock market and the increase in consumption over saving spurred rapid growth in income and sales tax yields. But now the subsequent decline and ongoing volatility of financial markets and the growth in personal debt raise questions about whether that pace of revenue growth will ever be seen again. Many believe that it will not.

North Carolina needs a finance system that reflects all of these new realities. The state must make changes to ensure that our economic growth can continue, that adequate services

can be provided, that the burden for government spending is spread fairly, and that emergencies – both natural and economic – can be withstood.

Tax Reform Efforts

The Commission to Modernize State Finances is the latest in a long line of efforts to address tax reform issues. North Carolina's leaders of both parties have recognized the need to make changes, although these changes have been slow in coming. In the late 1980s, the state moved to conform its income tax more closely to that of the federal government, eliminating thousands of North Carolinians from the income tax rolls. In the early 1990s, the Economic Futures Study Commission noted:

> Modernization also requires that the state tax system be made more responsive to the future growth of income and consumption in North Carolina. If this goal is not achieved, then the General Assembly will be forced to result time and again to ad hoc measures to increase revenues or control spending. By their nature, ad hoc revenue and expenditure adjustments under severe budget pressure are unlikely to contribute to tax equity or tax modernization, except by accident (p. 17).

This quote is equally valid today. The 1991 Commission recommended taxation of services and a reduction in the use of corporate incentives, two items discussed by this Commission. Within the past few years, both the General Assembly and Governor Easley have appointed commissions to make recommendations about the improvement of the tax code. The 2001 Governor's Efficiency and Loophole-Closing Commission made several recommendations to end tax preferences, the vast majority of which were ultimately adopted by the General Assembly. The 2001 Commission, which met for two months, urged further study of many of the issues that this Commission examined in its work. Certainly this Commission's work will not be the final word on tax reform. But it continues the discussion on this important matter.

THE PROCESSES OF THE COMMISSION

The Commission has been organized into three subcommittees: the New Economy subcommittee, the Tax Simplification subcommittee, and the Intergovernmental Relations subcommittee. Due to staff and member time conflicts, most of the work in recent months has been done in full Commission meetings.

Subcommittees received input from state agencies, including the Departments of Revenue and Commerce; local government associations and officials; nongovernmental tax experts; and taxpayer representatives.

At its October meeting, the Commission authorized Chairman Ross, the three subcommittee chairs, and Commission staff to delineate a series of recommendations that meet the Commission goals and reflect the Commission's deliberations. Those recommendations have

largely been amended or accepted, and some other recommendations are included in this report.

THE PROPOSED RECOMMENDATIONS – MOVE TO BROADER BASES AND LOWER RATES

The overall recommendation of the Commission is that state and local taxes have broader bases and, in some instances, lower rates. This general recommendation is the best way to ensure simplicity, fairness, sufficiency and stability.

Taxes

1. Sales Taxation

The sales and use tax generated the most discussion by the Commission, perhaps because it has been widely recognized as one of the major taxes most impacted by structural changes in the economy and by economic downturns. Last year, the state sales tax generated over $3.7 billion in revenue, although sales tax revenues fell short of projections by over six percent. Most economists agree that sales tax revenues in recent years have been greatly aided by the increase in Americans' consumption patterns, a trend that many believe cannot continue.

Today, most North Carolina consumers pay six and one-half or seven percent on most tangible goods and a limited number of services. Currently, the state sales tax rate is four and one-half percent on most tangible goods and a very limited amount of services. Local governments receive two or two and one-half percent, distributed partially on a point-of-collection basis and partially on a per-capita basis. (Mecklenburg County levies an additional one-half cent sales tax). Effective December 1, 2002, counties were permitted to levy an additional one-half cent sales tax by action of their boards of county commissioners. A large majority of counties have done so.

The sales tax is levied at different rates on different items. Manufactured homes, utilities, satellite television, airplanes, boats, manufacturing machinery – all of these items are taxed at rates between one and six percent at the state level. These differential rates increase the complexity of the tax code.

The sales and use tax faces two major challenges. First, the economy is growing substantially more dependent on services, thereby diminishing the current sales tax base, which

is primarily goods-based. Second, the growth in the use of the Internet and mail-order merchants to purchase taxable items makes compliance with sales and use tax more difficult, because many of these merchants do not have sufficient presence in North Carolina to be required to collect and remit the tax. Many taxpayers do not understand, or do not comply with, the longstanding law that they pay use tax on purchases consumed in North Carolina for which sales tax was not charged by the out-of-state merchant and it is virtually impossible to enforce this provision.

The original intent of the sales tax was to levy a tax on transactions. Because the economy has changed so much in the past seven decades, many transactions are not taxed or taxed at a partial rate. The Commission recommendations in this area are an attempt to comply with the original intent of the sales tax. The Commission does so with the recognition that many states have not accomplished such a restoration at this time.

The Commission makes the following recommendations regarding the sales and use tax:

- **Eliminate the differential rates of taxation of goods and services and remove caps on the sales and use taxes.** As explained above, there are eight different state sales tax rates. Caps, such as $80 on an "item" of machinery and equipment, are difficult to use in a fair and efficient manner. The Department of Revenue has noted that the existing system of rate and cap preferences is administratively burdensome. The Commission concludes that items should either be taxed fully or not at all, including sales-like taxes on amusements and entertainment.
- **Eliminate sales tax exemptions.** The sales tax specifically exempts numerous items in G.S. 105-164.13 and G.S. 105-164.14. The Commission recommends that each of these exemptions should be considered for elimination if appropriate, especially because many of these exemptions have not been reviewed in many years.

  The exemption of the state sales tax on food is an example of these exemptions. Currently, the North Carolina consumer pays two percent sales tax on food purchased for home consumption. The revenues from this two percent tax benefit only local governments, as it was only the state sales tax on food that was eliminated in the late 1990s. No change was made in the local effective sales tax rate of two percent on food to consumers. The additional one-half cent sales tax that most local governments have authorized (and others may authorize) after December 1, 2002 does not include food in the base. The Commission notes that the difference in base at the local government level over the tax of food must be changed in order to comply with the Streamlined Sales Tax agreement to which North Carolina is

committed. The Commission also notes that the General Assembly recently acted to exempt food from the sales tax base.

- **Consider the expansion of the sales tax base to include more services.** The Department of Revenue's Tax Research Division has found that the possible tax base of services would nearly double the existing sales tax base of goods and utilities. As such, the estimated state sales tax rate could be reduced markedly if all goods and services were taxed at that rate. Because so few states tax services, the data used to perform these calculations may not be sufficiently reliable to use for revenue projections. The Tax Research Division has used gross receipts as a proxy for sales to customers, although such receipts may include some things not related to sales to consumers, such as earnings on investments or the sale of some asset.

  The Commission notes that the failure to tax services contributes to the discrepancies and inconsistencies in the sales tax code. The Commission cites the fact that a lawn mower is taxed, but lawn service is not, to support this observation.

  However, the taxation of services is very complicated and changes should not be made without further analysis. The Commission notes several issues that merit closer consideration than our time has allowed. These include:

  Appropriate exemptions. Some observers have noted that some services, such as medical care, are so important and basic that an exemption may be merited. Moreover, the Commission is wary of taxing business inputs, which are goods and services used in the production of a final good or service, as this results in a cascading effect and reduces efficiency. Many services that could be taxed, such as legal and accounting services, are used by businesses, and thereby complicate the efficiency problem. However, this issue is not new in North Carolina tax policy. An Office of State Budget and Management study showed that businesses paid almost 25 percent of the general sales tax (excluding food bought for home consumption) in 1990-91.

  Competitiveness. The taxation of services varies across states. Many states tax the repair of tangible personal property, while very few tax professional services. Any future analysis should benefit from experiences of other states in approaching service taxation.

  Representatives of service industries testified that such taxation would be burdensome and add to the regressivity of the system as a whole.

Services have become such an important part of the economy that any examination of a tax on consumption – the goal of the sales tax – should consider the inclusion of services in the tax base. Further, the services sector of our economy is expected to continue to grow at a much greater rate than that of goods.

- **Adopt changes required to comply with the Streamlined Sales Tax Agreement.** Representatives from 35 states, including North Carolina, recently completed a historic agreement to simplify state and local sales tax systems across the nation. Charles Collins, the former director of the Sales and Use Tax Division, was one of the co-chairs of the commission that negotiated this agreement after several years of work. The General Assembly has approved several interim steps to ensure our participation in the agreement. This Commission recommends the adoption of further measures to ensure equity among competitors and ease administrative burden on merchants and their customers.

- **Simplify the administration of local sales taxes.** The Department of Revenue has noted that it is difficult for taxpayers and the Department to determine the source county for local sales taxes. A state formula for distributing sales tax revenues to counties and municipalities would be the easiest way to ensure fairness and compliance.

2. *Individual Income Tax*

The individual income tax is the workhorse of the state tax system. It generates over one-half of all General Fund revenue. However, its actual yield has fallen short of projections in recent years. In 2001-02, it fell almost 13 percent – over $1 billion – short of its projection. This volatility is largely due to the drop in income from capital gains, bonuses and other such nonwage income. Currently, the state ranks 11th nationally in individual income tax burden, primarily because the state pays for a greater share of education, court, and correctional expenses than most other states. Local governments pay a smaller share of these expenses, leading to lower-than-average property tax burden described earlier.

The Commission has identified several major issues surrounding the income tax. First, North Carolina's income tax marginal rates are significantly higher than those in other states, especially for higher-income taxpayers. However, most of these taxpayers can deduct state income taxes paid from federal taxable income, thus reducing the real burden of their state income tax paid by nearly 40 percent. Second, the income tax has grown increasingly complex in recent years, due to a proliferation of tax credits and the growing gap between federal exemptions and deductions and state exemptions and deductions. Third, North Carolina's state

and local tax system is regressive, and a strong individual income tax helps offset that regressivity. Fourth, the state has higher marginal income tax rates than most Southeastern states, giving rise to a concern that the state has difficulty competing for crucial economic development and job creation opportunities. . The Commission also noted that a significant number of taxpayers have very little taxable income and pay a very small share of the income tax. In 2000, taxpayers with less than $10,000 in taxable income represented one-third (almost one million) of the taxpayers, but less than four percent of income taxes paid.

The Commission recommends the following:

- **The state income tax should tie more closely to the federal tax code.** The federal income tax code is progressive. The state could simplify the state income tax by eliminating most adjustments to federal definitions of income. Some adjustments, such as those required by the *Bailey* decision, would have to remain. The Commission notes that the simplest solution would be to use the federal definition of taxable income. However, that use would result in a substantial increase in the value of standard deductions and personal exemptions, and therefore would reduce state income tax receipts. An alternative would be to use a broader version of income, such as federal adjusted gross income or total income. The state could also use its own values for standard deductions and personal exemption. These changes would broaden the base and allow the tax rates to be lowered to levels similar to those in other states. There are 16 tax credits (outside of business tax credits) in the individual income tax code, many of which have very high error rates.

- **Adopt strategies to help low-income taxpayers.** Several Commission members believe an earned income tax credit, such as proposed by Gov. Easley last year, would provide targeted relief that offsets regressivity elsewhere in the system. The earned income tax credit is part of the federal tax system. Families with children and earnings below $30,000 are the primary recipients of the credit. However, the creation of a new credit when others are repealed adds some new administrative difficulty, although the tie to the federal credit may mitigate substantial enforcement issues. The Commission also discussed other alternatives to achieve the goal of relief for low-income income taxpayers. These include: a "no-tax" threshold for those with taxable incomes below $10,000 or a reduction in the beginning marginal income tax rate from six percent to a lower number.

3. *Corporate Income/Franchise Taxes*

The corporate income tax is one of the most volatile of all revenue sources. Its General Fund yield fell 30 percent below expectations last year, and was about half of its 2000 high. There are a number of reasons for the decrease in liability, such as declining corporate profits, the increased use of tax planning schemes by multistate corporations and the use of tax credits.

The state's corporate income tax rate of 6.9 percent is higher than rates in most of our competitor states. Because economic growth and job creation are so crucial to the ability of a state to meet its financial needs, changes to business taxation must be thoroughly analyzed so as to maintain a good business climate.

The Commission recommends the following:

- **Elimination or simplification in the use of tax credits.** Since 1996, the state has enacted a series of tax law changes geared to promote economic development (the William S. Lee Act). In 2002, the General Assembly enacted legislation to tighten eligibility for these tax credits, especially in urban counties. Gov. Easley has argued for reduced use of tax subsidies, replacing these subsidies with performance-based grants designed to increase efficiency. The Commission finds these efforts should be continued in order to help maintain our competitiveness.

  The Commission finds that a research and development tax credit should remain, due to its substantial economic benefits. The Department of Commerce and some taxpayers contend that North Carolina's tax incentives are less generous than those provided in other states.

- **Simplify taxation by moving to combined reporting by related entities, as required at the federal level.** In the past two years, the General Assembly has acted to limit the ability of related corporations to reduce their North Carolina tax liability. The move to a combined reporting system, required in many other states, may clarify the rules for both taxpayers and tax administrators. Combined reporting is required at the federal level and may help simplify the administrative burden for business taxpayers. The Commission recommends that this move be done carefully, as the effects on state revenues are not easily determined. Department of Revenue staff would have to be trained to handle this shift.
- **Modernize the franchise tax.** The Commission finds that the evolution of new forms of business organization has led to inequities in the imposition of franchise

taxes. The Commission recommends that the state impose the franchise tax on all types of business organizations, not just on traditional corporations. The Commission recommends that the revenues generated from this base broadening could be used to establish a minimum net worth threshold for payment of the tax. The franchise tax rate could also be reduced in the process.

- **Consider the effect of establishing a throwout provision.** held that all income of a multistate corporation should be taxed, and taxed only once, among states where the corporation conducts business. The majority of the states with corporate income taxes have a "throwback" or "throwout" provision to ensure that all of a corporation's income is taxed. A "throwout" rule provides that the corporation's sales to customers in states where it has no nexus, and therefore is not taxed, are not included in the calculation of state tax liability. However, the Commission recognizes that North Carolina's border states do not have a throwback or throwout rule, and that the General Assembly did not adopt the throwout provision that was approved by the House of Representatives as part of their original 2002-03 budget proposal.

- **Conform more closely to the federal definition of corporate income.** This simplifies tax administration and computation. There are now several dozen adjustments to the federal income in determining state income, and each should be evaluated on its merits. The interest expense deduction for financial institutions is the best-known example of these types of adjustments. The Commission also finds that North Carolina is one of the few states to use net economic loss rather than net operating loss in the calculation of state corporate income tax, and that the effects of using federal net operating loss instead of net economic loss be considered.

- **Consider the effects of a move back to the equal weighting of payroll, property and sales in determining the share of income taxed by North Carolina.** Currently, multistate corporations calculate their North Carolina income tax liability by determining their shares of property, payroll, and sales in North Carolina. In the late 1980s, the formula was changed from equal weighting of these three factors to a double-weighting of the sales factor. This change was made in order to provide relief to companies that own significant property and employ a significant portion of their total workforce in North Carolina. This weighting formula results in a net loss of approximately $60 million to the state

coffers when compared to the previous formula. Other corporations, especially those that conduct all of their business within North Carolina, have to pay higher corporate income taxes in order to compensate for this loss. For this reason, the Commission recommends consideration of the effects of returning to the previous formula. Most states, however, have moved to North Carolina's current system of "double-weighting" the sales factor in order to maintain competitiveness.

4. Other Tax Issues

The Commission notes that the state receives substantial revenue from taxes on specific products, such as alcohol, cigarettes, and gasoline. Some Commission members noted that these types of taxes may result in economic inefficiencies, as the singling out of certain products and industries violates the principle of broad bases and low rates. North Carolina alcohol taxes are generally higher than those in other states, while its cigarette taxes are far below the national average. The state has a higher than average gasoline tax, resulting from the fact that the state pays a higher than average share of the costs of road and highway construction than do other states.

The Intergovernmental Relations Subcommittee spent substantial time on local government finance issues. Because state-local roles were generally set in the 1930s, it is time for some updated changes. For this reason, the Commission recommends the following:

- **Shift Medicaid program costs from counties to the state government.** Medicaid expenditures are highest in the poorest counties in the state, because the program provides health care to low-income families, the aged, and the disabled. Because counties have no policy authority over Medicaid and many do not have the tax base to continue to fund a substantial share of this rapidly growing program, the state should pay all of the nonfederal costs of the program, as do over 40 other states. The Commission notes that the state half-cent sales tax levied in 2001 and due to expire on June 30, 2003 could be extended to pay for most of the current county share of Medicaid costs.
- **Establish a new State-Local Relations Commission.** In May, the Commission approved a recommendation to the Governor that he request that the General Assembly establish a Commission on State-Local Relations. This Commission should re-examine the ability of counties to provide crucial public facilities such as courthouses and public schools, the status of current functions of state and local governments, the ability of local governments to levy certain taxes from a menu authorized by the General Assembly, the

content of such a menu, and other issues that this Commission felt important, but beyond its scope and time. This Commission should have a definite sunset date and report back to the Governor and General Assembly as soon as possible.

- **Review the state unemployment insurance tax laws.** Although not part of the General Fund, unemployment insurance taxes should be examined as well in any comprehensive examination of the tax code. The Commission recommends that N.C. unemployment tax laws be reviewed and changed as needed to avoid the possibility that some entities may adopt techniques that artificially and unfairly reduce state unemployment insurance tax collections.

Other Nontax Finance Issues

1. Fees

The Commission believes that fees should be routinely evaluated to determine if they are covering the appropriate share of the cost of government services to which they apply. The Office of State Budget has produced a 359-page report on the various fees assessed by state government agencies and boards. The Commission recommends that the State Budget Office recommend an increase in fees to cover the cost of selected services, especially for those that have not been increased in several decades. This analysis should include consideration of the cost of collecting fees and perhaps recommend some fees to be eliminated.

For instance, some Commission members argued that some fees – or fee-like revenues such as privilege license taxes and installment paper taxes – are administratively burdensome for both state officials and taxpayers. The average privilege license tax is $185, with the average professional privilege license tax of $45. Repeal of some such fees that are not directly related to services, serving as *de facto* taxes, may also be appropriate.

2. Rainy Day Fund

North Carolina's Executive Budget Act requires that the state deposit 25 percent of the General Fund money remaining unspent at the end of the fiscal year into the state's Savings Reserve Account (the "rainy day" fund), until the fund reaches five percent of the prior year's general fund spending. While the state was able to reach this five percent target for some time, lawmakers decided to use rainy day funds for Hurricane Floyd relief and recovery and for payment of court judgments and have not maintained the fund at an appropriate level.

Recent research on economic downturns in North Carolina history showed that the recessions in recent years have resulted in increased severity of the revenue gap. The research

concluded that a five percent rainy day fund would fall far short of the likely need, if the goal were to maintain the same level of expenditures in times of shortfall, while making no change in revenue laws.

The Commission recommends that the rainy day fund cap be raised substantially above the level of five percent. The Local Government Commission requires that local governments maintain a fund balance of at least eight percent in order to issue debt, far above the state's present cap of five percent. The Commission believes that the state should replenish the fund as quickly as possible after its expenditure. Rather than relying exclusively on monies left over at the end of the year to replenish the fund, as is the current case, the General Assembly should appropriate monies to ensure that the fund remains healthy. Moreover, the state should more strictly limit the uses of the rainy day proceeds; specifically, to stabilize the general fund in an economic downturn.

3. Future Tax Changes

A number of observers have attributed the state's current budget problems to the $1.5 billion in permanent annual tax cuts enacted by the General Assembly in the late 1990s. These tax cuts were not accompanied by commensurate reductions in state spending, which have contributed to a structural deficit.

The state tax cuts were permanent in nature. This permanent loss of taxes through elimination of entire tax schedules makes a future increase in taxes even more difficult.

The Commission recommends that future tax relief be provided through one-time rebates or temporary rate reductions. Minnesota, Oregon and Colorado are among the states that provided rebate checks to their taxpayers when times were good and have ceased to do so during these challenging times, thus mitigating the need for tax increases.

4. Tax Procedure Reforms

Any discussion of the tax code should include discussion of tax procedures. The complexity of the economy and the tax code make tax administration more difficult for tax administrators and taxpayers. The Commission finds that it is important to reduce the possibility of conflicts over interpretation of state tax laws.

- **Clarify the Secretary of Revenue's authority to address inappropriate tax planning strategies by taxpayers.** The Commission recommends clarification of the Secretary of Revenue's power to ensure that it is clear that the Secretary can

void intercompany and other accounting transactions that are distortive, do not properly reflect state taxable income, or serve no legitimate business purpose.

- **Review tax hearing and appeal processes.** The Commission recommends a review of the administrative tax hearing process within the Department of Revenue, the appeal process to the Tax Review Board, and the Property Tax Commission for opportunities to streamline and otherwise improve the process, including the possibility of a new tax court.

5. Other Tax Policy Ideas

The Commission also heard testimony on, but did not have time to consider fully, some other tax policy proposals. The Commission makes no recommendations in regard to these ideas, other than to identify them as worthy of mention.

- Increase the cigarette tax in order to reduce the burden of other taxes. North Carolina's cigarette tax is third-lowest in the nation and the revenues from an increase could be used to replace revenues lost from a reduction in burden of other taxes.
- Adoption of "green taxes and fees." Testimony from environmental advocates found that "green taxes and fees" could result in increased revenue, better environmental outcomes, and improved adherence to the Commission's goal that those who benefit from a service pay for its cost.

CONCLUSION

The budget crisis may provide the motivation for necessary changes in how our state and local governments obtain the revenues to provide an appropriate level of public services. The last wholesale revision of North Carolina's government finances took place during the Great Depression. Perhaps these important recommendations will be accomplished in a similar manner. The Commission is one of a long line of groups to recommend crucial changes to the tax code. This long recognition that long-term systemic changes are required will help ensure that North Carolina emerges with a more stable, fairer and simpler system of raising revenue for important public services.

APPENDICES

Appendix 1 - List of Commission Members

Appendix 2 – Sources for General Fund Revenue, as a Pie Chart

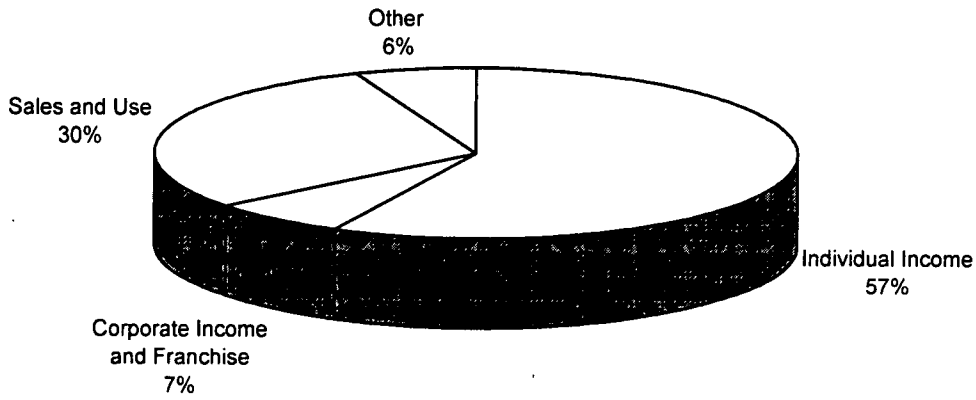
Appendix 3 – General Fund Sources of Revenue Over Time

Appendix 1: List of Commission Members

The Honorable Thomas Ross, Chairman	Winston-Salem
The Honorable Gordon Allen	Roxboro
The Honorable Daniel Clodfelter	Charlotte
The Honorable Wilma Sherrill	Asheville
The Honorable David Hoyle	Dallas
Mr. John Medlin, Jr.	Winston-Salem
The Honorable Lucy Allen	Louisburg
Mr. Charles Mercer, Jr.	Raleigh
Mr. Michael Hannah	Raleigh
Ms. Kay Hobart	Raleigh
Mr. James Talton, Jr.	Raleigh
Mr. John Sanders	Chapel Hill
Mr. Jack Cummings, Jr.	Raleigh
Dr. Ben Russo	Matthews

Appendix 2

NORTH CAROLINA GENERAL FUND TAX COLLECTIONS
(2001-02)



Individual Income	$7,134,629,832
Corporate Income and Franchise	855,593,220
Sales and Use	3,705,769,832
Other	749,616,899
Total	$12,445,609,783

N. C. Office of State Budget and Management
Summary of Actual Tax Revenue Collected by Category
For Fiscal Years 1980-81 Through 2001-2002

FY	Ind Income	%	Sales	%	Corporate	%	Franchise	%	Other	%	Total
1980-81	1,303.5	45.8%	737.1	25.9%	279.8	9.8%	235.3	8.3%	290.2	10.2%	**2,845.9**
1981-82	1,449.4	47.1%	777.4	25.3%	277.4	9.0%	269.8	8.8%	303.7	9.9%	**3,077.7**
1982-83	1,550.1	47.3%	823.4	25.1%	306.5	9.3%	298.6	9.1%	300.4	9.2%	**3,279.0**
1983-84	1,785.0	46.8%	999.0	26.2%	367.8	9.6%	326.8	8.6%	335.8	8.8%	**3,814.4**
1984-85	2,023.5	46.7%	1,155.8	26.7%	490.0	11.3%	310.1	7.2%	357.3	8.2%	**4,336.7**
1985-86	2,206.8	47.0%	1,380.4	29.4%	510.7	10.9%	197.6	4.2%	399.1	8.5%	**4,694.6**
1986-87	2,565.9	49.5%	1,451.6	28.0%	563.5	10.9%	206.5	4.0%	392.9	7.6%	**5,180.4**
1987-88	2,686.8	48.4%	1,555.3	28.0%	626.0	11.3%	234.8	4.2%	448.5	8.1%	**5,551.4**
1988-89	3,002.3	50.6%	1,681.7	28.4%	549.4	9.3%	236.3	4.0%	458.9	7.7%	**5,928.6**
1989-90	3,390.4	51.7%	1,762.7	26.9%	557.8	8.5%	262.8	4.0%	587.8	9.0%	**6,561.5**
1990-91	3,534.5	52.8%	1,682.3	25.1%	493.2	7.4%	372.9	5.6%	609.7	9.1%	**6,692.6**
1991-92	3,583.0	48.2%	2,161.4	29.1%	606.2	8.1%	407.0	5.5%	680.9	9.2%	**7,438.5**
1992-93	3,992.0	50.6%	2,344.1	29.7%	429.8	5.5%	420.0	5.3%	697.1	8.8%	**7,883.0**
1993-94	4,254.5	50.0%	2,578.9	30.3%	487.8	5.7%	439.3	5.2%	756.2	8.9%	**8,516.7**
1994-95	4,665.5	49.8%	2,781.7	29.7%	649.4	6.9%	458.1	4.9%	811.2	8.7%	**9,365.9**
1995-96	4,800.0	50.7%	2,958.1	31.3%	673.9	7.1%	355.9	3.8%	670.8	7.1%	**9,458.7**
1996-97	5,330.0	52.1%	3,127.7	30.5%	717.8	7.0%	387.8	3.8%	675.9	6.6%	**10,239.2**
1997-98	6,028.9	54.4%	3,255.4	29.3%	696.3	6.3%	407.3	3.7%	704.6	6.4%	**11,092.5**
1998-99	6,606.5	55.2%	3,376.2	28.2%	848.5	7.1%	409.6	3.4%	724.4	6.1%	**11,965.2**
1999-00	7,080.1	57.1%	3,354.9	27.1%	903.2	7.3%	307.0	2.5%	745.8	6.0%	**12,391.0**
2000-01	7,391.4	58.8%	3,435.6	27.3%	460.3	3.7%	580.4	4.6%	705.4	5.6%	**12,573.1**
2001-02	7,134.6	57.3%	3,713.1	29.8%	409.3	3.3%	446.3	3.6%	748.6	6.0%	**12,451.9**

State and Local Fiscal Modernization Study Commission

December 19, 2006
AGENDA

9:00 –11:00	**Demonstration of IEI's Tax Calculator**	**Karl Smith, School of Government Research Associate, UNC-CH and Institute for Emerging Issues Fellow**

The tax calculator is a tool that will allow the Commission to see at a glance how changes in various state and local taxes impact revenue at the state and local level, tradeoffs between base broadening and rate reductions, and other options that might be considered by the Commission. After the presentation, Professors Ben Russo, Dan Schisler, Doug Shackelford and Mike Walden will answer specific questions dealing with the sales tax, individual and corporate income tax, and local taxes.

11:00 – 12:00	**Principles of State and Local Government Spending**	**Roland Stephen, Assistant Director for Research and Policy, Institute for Emerging Issues**

The purpose of this presentation is to discuss the basic principles of state and local government spending including efficiency, appropriate responsibility and control, transparency and equity, and to illustrate how principles might be used by the Commission in its deliberations.

12:00 – 1:30	**Lunch meetings with subcommittees**	**Sponsored by the Z. Smith Reynolds Foundation**

During lunch, subcommittees will meet to review their charges and plan their meeting schedules

VISITOR REGISTRATION SHEET

State & Local Fiscal Modernization — Dec. 19, 2006

Name of Committee — **Date**

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Carolyn Meiners	NCACC
Michael Haley	Commerce
Heather K Gates	NCPHA, Health Directors Assoc.
Roland Stephen	IEI
Dana Simpson	Smith Anderson
Joseph Coletti	John Locke Fdn
LISA NOLEN	GOVERNOR'S OFC
Jim Holman	CUMTF
Yael Rustom	NCGA - CA
Carla Farmer	NCGA - CA
Cindy Garrison	NCGA - CA

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Jim Johnson	Blount Street Advisors
John Goodman	NCCRI
Ken Melton	N.C. DOR.
Meg Gray	NC Budget & Tax Center
Anthony Allen	NCAL
Jason Cournoyer	NC Policy Watch
Rob Schofield	NC Policy Watch
Ellis Hankins	NCLM
Susan Burgess	Mayor Pro Tem, Charlotte NCLM
Boyd Gamble	City of Charlotte

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Cam Cover	BPMHC
Jimmy Rinehart	Here w/ wife
John Long	Martin Marietta Materials
Cam Brawley	EY
Andy Lomenick	NCLM
Patrick T. Buffkin	ALLEY ASSOCIATES, INC.
Mary Klenz	League of Women Voters of NC

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State & Local Fiscal Modernization — Dec. 19, 2006

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Rebecca Trondman	NCACC
Kara Millonzi	School of Gov't
DAVID LAWRENCE	— —
Diane Cherry	IFB
Shellie Edge	Institute for Emerging Issues
Michelle Bodlas	Institute for Emerging Issues
Jan Winters	Caston County
Larry Goode	NCGA
Jack Cozort	Dell
Fran Valluzzo	Dell

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3. Name: MARTHA GADISON

4. Name: EARL COKER

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GEORGE ROBINSON
ERNIE SHERRELL

State and Local Fiscal Modernization Study Commission

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IEI's Tax Calculator

Income Tax

The income tax, both personal and corporate, is an important source of revenue for the state of North Carolina, with the individual income tax accounting for over one half of total state general fund revenue. It grows with the economy as more people move into higher personal income tax brackets (which are not indexed for inflation). On the other hand, it is a very volatile revenue source, which is made more acute by having an income tax structure with a relatively high top rate. Currently, North Carolina taxes a modified version of federal taxable income. The personal income tax structure is mildly progressive with rates staring at 6 percent and increasing to 8 percent (effective January 1, 2007).

The income tax component of the tax calculator will immediately display the consequences for revenue raising, progressivity and the ability of the tax to grow with the economy. This component of the tax calculator uses 2004 income tax data from the North Carolina Department of Revenue and the Internal Revenue Service.

The following options or choices can be made:

- Broadening the personal income tax base to begin with federal adjusted gross income (AGI) rather than federal taxable income. Federal AGI is calculated before any allowance for itemized deductions, the standard deduction, and personal exemptions. It also may include up to 85 percent of social security benefits.

- The individual income ax rate for five income tax brackets (the current married filing joint brackets):
    - Under $20,000
    - $20,000 – $50,000
    - $50,000 – $100,000
    - $100,000 – $200,000
    - Over $200,000

- The size of a personal exemption for each dependent claimed by a taxpayer
- The size of a standard deduction for each tax return filed

With respect to the corporate income tax, the following options or choices can be made:

- The corporate income tax rate
- Whether to allow deductions for charitable deductions
- Whether to allow deductions for economic losses
- Whether to allow special exemptions
- Whether to allow development credits
- The impact of adopting a combined reporting regime

Local Taxes

The primary revenue sources for local governments in North Carolina are the property tax and the local portion (2.5 percent) of the retail sales tax.

In general, property tax burdens are low in North Carolina compared to surrounding states. The low property tax burdens are a result of many factors including the fact that North Carolina's state government has assumed the responsibility for paying for roads and a large fraction of K-12 education. In addition, North Carolina's local governments are some of the best managed in the nation.

Nonetheless, local governments face ongoing challenges. The shrinking sales tax base is a problem for them just as it is for state government. Any solution for this problem will require action at the state level. The other challenge is that property tax revenues tend not to keep up with growing needs. These problems take different forms in urban and rural counties.

The local revenue component of the tax calculator allows the user to see options for different counties around the state. The calculator uses 2004 sales tax data from the North Carolina Department of Revenue, consumer spending data from the Bureau of Economic Analysis at the Department of Commerce and Property Tax and other local data from the Treasurer's office. The following options or choices can be made:

- The sales tax rate
- Whether or not to tax groceries
- The property tax rate

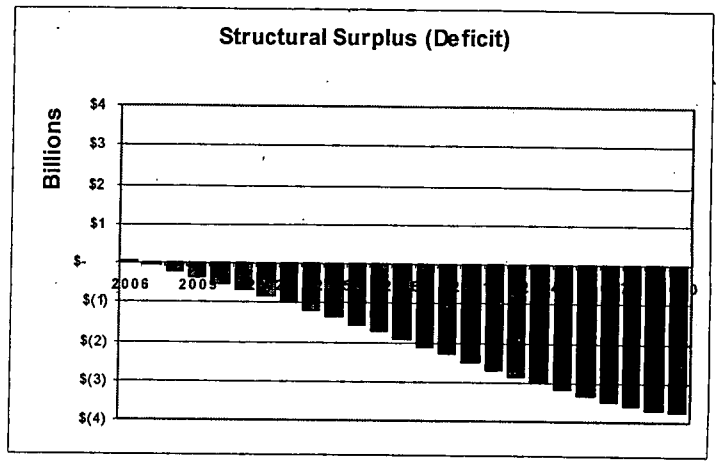
- Several additional local revenue options including:
    - An impact fee levied per new home
    - A real estate transfer tax
    - An additional prepared food and beverage tax
    - An additional entertainment admissions tax
    - A county vehicle tag tax
    - Occupancy tax

Sample Tax Calculator Scenarios

One use of the calculator is to model scenarios under which the state can assume responsibility for Medicaid and still meet its long term fiscal obligations. With no changes to the tax system, the state's assuming responsibility for Medicaid would result in large and growing structural deficits. Three dramatically different scenarios are presented to show the range of options that the calculator can model.

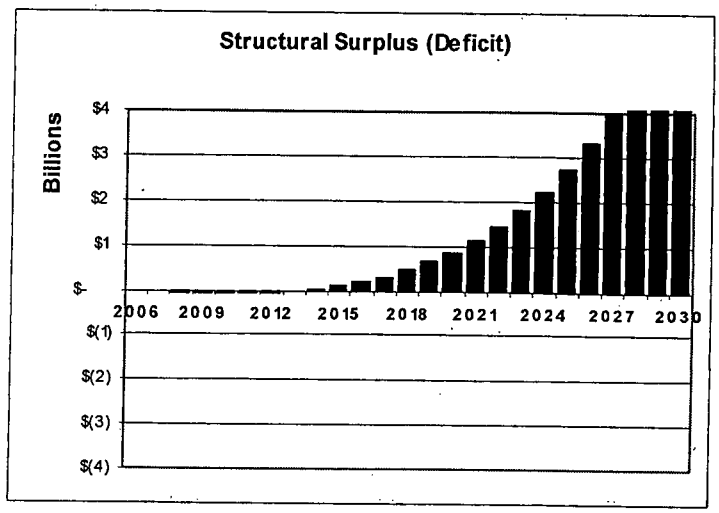
Scenario One

Scenario one attempts to achieve the broadest base and lowest tax rates with no concern for progressivity. The personal income tax rate is a flat 4.0%. The base is federal adjusted gross income (AGI) and there are no deductions or exemptions. There are no business taxes. The statewide sales tax is 2% and all goods and services are included in the base. The local sales tax rate is 1%. While this scenario is revenue-neutral in year one, it results in large deficits in later years.



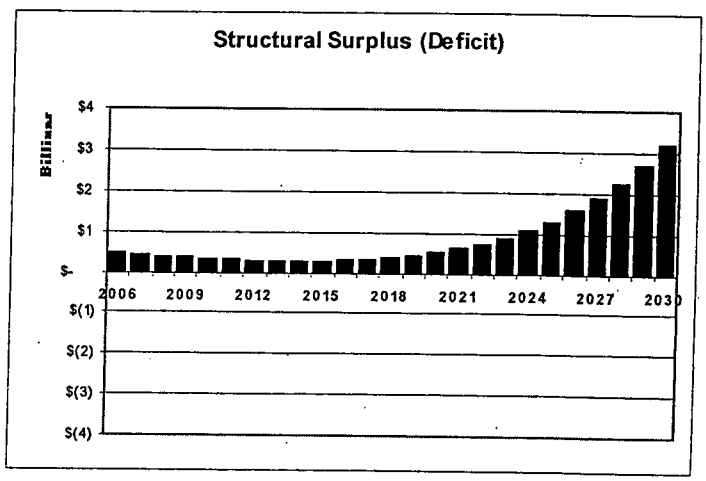
Scenario Two

Scenario two retains a progressive individual income tax but rates are lowered by one percentage point for the bottom three tax brackets. As in scenario one, the individual income tax base is AGI. The personal exemption is raised by $2,000 for the lowest bracket and $1,000 for the second lowest. Combined reporting is introduced for the corporate income tax. The state sales tax base is expanded to all goods and services and the rate lowered to 1.25%. The local rate is lowered to .75%. The result is a balanced budget for the next ten years and then sharply increasing surpluses.



Scenario Three

Scenario three is somewhere between scenario one and two. As in the first two scenarios, AGI is used as the income tax base. In scenario three, all tax brackets are lowered to a flat 5% but the personal exemption amount is increased for lower income taxpayers and decreased for upper income taxpayers. The franchise tax is eliminated, the corporate income tax rate is reduced to 5%, combined reporting is added and special corporate exemptions and credits are eliminated. The sales tax base is expanded to all goods and services at a state rate of 2% and a local rate of 1%. The result is small surpluses over the next ten years followed by increasing surpluses.



FY 2006-07
Tuition and Fee Comparisons
for UNC Institutions

	Institution Name	Resident Tuition and Fees	Nonresident Tuition and Fees
1	**Appalachian State University**	**4,081**	**13,823**
2	Bowling Green State University	9,074	17,678
3	Eastern Illinois University	7,069	17,482
4	College of Charleston	7,234	16,800
5	California State University at Chico	3,402	13,572
6	California State University at Fresno	3,031	13,201
7	George Mason University	6,408	18,552
8	Georgia Southern University	3,612	11,196
9	James Madison University	6,290	16,232
10	Miami University (Ohio)	22,997	23,017
11	Sam Houston State University	5,056	13,306
12	Stephen F Austin State University	5,232	13,482
13	Towson University	7,164	16,522
14	University of Wisconsin at La Crosse	5,398	12,873
15	University of Wisconsin at Whitewater	5,567	13,042
16	University of Northern Iowa	5,912	13,830
17	West Chester University of Pennsylvania	6,293	13,916
18	Western Illinois University	7,411	10,130
19	Western Washington University	5,003	15,550

Source: The Chronicle of Higher Education. The information was compiled by the College Board as part of "The Annual Survey of Colleges of the College Board."

FY 2006-07
Tuition and Fee Comparisons
for UNC Institutions

	Institution Name	Resident Tuition and Fees	Nonresident Tuition and Fees
1	**East Carolina University**	**4,003**	**14,517**
2	Florida International University	3,466	15,865
3	Northern Illinois University	7,205	12,755
4	Ohio University	8,727	17,691
5	Old Dominion University	6,098	16,658
6	State University of New York at Buffalo	6,128	12,388
7	Texas Tech University	6,339	14,589
8	University of Louisville	6,252	16,072
9	University of Missouri at Kansas City	7,659	17,925
10	University of North Dakota	5,792	13,786
11	University of South Carolina at Columbia	7,808	20,236
12	Virginia Commonwealth University	5,819	17,556
13	Western Michigan University	6,866	16,806
14	Wright State University	7,278	14,004
15	University of Nevada at Reno	3,684	13,595
16	University of North Dakota	5,792	13,786

Source: The Chronicle of Higher Education. The information was compiled by the College Board as part of "The Annual Survey of Colleges of the College Board."

FY 2006-07
Tuition and Fee Comparisons
for UNC Institutions

	Institution Name	Resident Tuition and Fees	Nonresident Tuition and Fees
1	Georgia Inst of Technology	4,926	20,272
2	Iowa State University	5,860	16,354
3	Michigan State University	8,793	21,438
4	**North Carolina State University**	**4,784**	**16,982**
5	Ohio State University	8,667	20,562
6	Pennsylvania State University at University Park	12,164	22,712
7	Purdue University	7,096	21,266
8	Texas A&M University at College Station	6,966	15,216
9	University of California at Davis	7,593	26,277
10	University of Florida	3,206	17,791
11	University of Georgia	4,964	18,040
12	University of Illinois at Urbana-Champaign	9,882	23,968
13	University of Maryland at C Park	7,906	21,345
14	University of Minnesota-Twin Cities	9,373	21,003
15	University of Wisconsin at Madison	6,726	20,726
16	Virginia Tech	6,973	19,049

Source: The Chronicle of Higher Education. The information was compiled by the College Board as part of "The Annual Survey of Colleges of the College Board."

FY 2006-07
Tuition and Fee Comparisons
for UNC Institutions

	Institution Name	Resident Tuition and Fees	Nonresident Tuition and Fees
1	University of California at Berkeley	6,654	25,338
2	University of California at Los Angeles	6,522	25,206
3	University of Florida	3,206	17,791
4	University of Illinois at Urbana-Champaign	9,882	23,968
5	University of Michigan at Ann Arbor	9,723	29,131
6	**University of North Carolina at Chapel Hill**	**5,034**	**19,682**
7	University of Pittsburgh	12,138	21,456
8	University of Texas at Austin	7,630	20,364
9	University of Virginia	7,845	25,945
10	University of Washington	5,985	21,283
11	University of Wisconsin at Madison	6,726	20,726

Source: The Chronicle of Higher Education. The information was compiled by the College Board as part of "The Annual Survey of Colleges of the College Board."

FY 2006-07
Tuition and Fee Comparisons
for UNC Institutions

	Institution Name	Resident Tuition and Fees	Nonresident Tuition and Fees
1	Armstrong Atlantic State University	3,074	10,756
2	Colorado State University at Pueblo	4,190	14,758
3	University of Louisiana at Monroe	3,501	9,453
4	Florida Gulf Coast University	3,560	15,483
5	Georgia C & State University	4,424	15,352
6	Jackson State University	4,224	9,540
7	Lock Haven University of Pennsylvania	6,445	12,068
8	Longwood University	7,589	15,209
9	Murray State University	4,998	13,566
10	Radford University	5,746	13,494
11	University of Central Arkansas	6,010	10,675
12	University of Maryland-Eastern Shore	5,908	12,475
13	University of North Alabama	4,651	8,419
14	University of South Carolina Upstate	7,344	14,782
15	University of Tennessee at Chattanooga	4,688	14,086
16	**Winston-Salem State University**	**3,108**	**11,748**
17	Winthrop University	9,500	17,564

Source: The Chronicle of Higher Education. The information was compiled by the College Board as part of "The Annual Survey of Colleges of the College Board."

Fiscal Year 2005-06
Tuition and Fee Comparisons
for UNC Peer Institutions

	Institution name	Resident Tuition and Fees	Nonresident Tuition and Fees
1	California State University at Fresno	$2,933	$13,103
2	California State University at Chico	$3,370	$13,540
3	**Appalachian State University**	**$3,436**	**$13,178**
4	Georgia Southern University	$3,462	$10,778
5	Sam Houston State University	$4,560	$12,240
6	Stephen F Austin State University	$4,718	$12,998
7	Western Washington University	$4,737	$13,896
8	University of Wisconsin at La Crosse	$5,074	$15,120
9	University of Wisconsin at Whitewater	$5,130	$15,528
10	University of Northern Iowa	$5,602	$13,214
11	Eastern Illinois University	$5,842	$13,887
12	George Mason University	$5,880	$19,770
13	James Madison University	$5,886	$15,322
14	West Chester U of Pennsylvania	$6,147	$13,507
15	Western Illinois University	$6,411	$8,895
16	College of Charleston	$6,668	$15,342
17	Towson University	$7,096	$16,030
18	Bowling Green State University	$8,544	$16,174
19	Miami University (Ohio)	$21,487	$21,507

Source: The Chronicle of Higher Education. The information was compiled by the College Board as part of "The Annual Survey of Colleges of the College Board."

Fiscal Year 2005-06
Tuition and Fee Comparisons
for UNC Peer Institutions

	Institution name	Resident Tuition and Fees	Nonresident Tuition and Fees
1	University of Nevada at Reno	$3,060	$12,527
2	Florida International University	$3,210	$15,609
3	**East Carolina University**	**$3,627**	**$14,141**
4	University of North Dakota	$5,327	$12,578
5	Virginia Commonwealth University	$5,445	$17,380
6	University of Louisville	$5,532	$15,092
7	Old Dominion University	$5,614	$15,394
8	State University of New York at Buffalo	$6,059	$12,319
9	Texas Tech University	$6,152	$14,432
10	University of Wisconsin at Milwaukee	$6,220	$18,972
11	Western Michigan University	$6,478	$15,856
12	Northern Illinois University	$6,638	$11,699
13	Wright State University	$6,864	$13,239
14	University of South Carolina at Columbia	$7,314	$18,956
15	University of Missouri at Kansas City	$7,425	$17,202
16	Ohio University	$8,235	$17,199

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Fiscal Year 2005-06
Tuition and Fee Comparisons
for UNC Peer Institutions

	Institution name	Resident Tuition and Fees	Nonresident Tuition and Fees
1	**Elizabeth City State University**	**$2,493**	**$10,832**
2	Savannah State University	$3,056	$10,372
3	Western State College of Colorado	$3,138	$11,754
4	Concord College	$3,912	$8,686
5	University of Arkansas at Pine Bluff	$4,254	$8,439
6	Black Hills State University	$4,754	$9,741
7	Central State University	$4,994	$10,814
8	SUNY College at Old Westbury	$5,071	$11,331
9	University of Virginia's College at Wise	$5,081	$15,159
10	Texas A&M University at Galveston	$5,118	$13,398
11	University of Maine at Farmington	$5,541	$12,771
12	Christopher Newport University	$5,826	$12,898
13	Eastern Oregon University	$5,840	$5,840
14	Lyndon State College	$6,484	$13,804
15	Coastal Carolina University	$6,940	$15,180

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Fiscal Year 2005-06
Tuition and Fee Comparisons
for UNC Peer Institutions

	Institution name	Resident Tuition and Fees	Nonresident Tuition and Fees
1	**Fayetteville State University**	**$2,520**	**$12,257**
2	California State University at San Marcos	$3,062	$13,232
3	Southwestern Oklahoma State University	$3,240	$7,740
4	Tarleton State University	$4,171	$12,451
5	University of North Alabama	$4,282	$7,930
6	Angelo State University	$4,290	$12,570
7	Western Oregon University	$4,683	$13,734
8	Northern State University	$4,700	$9,687
9	University of Wisconsin--Parkside	$5,001	$15,767
10	SUNY College at Oneonta	$5,362	$11,622
11	Bowie State University	$5,481	$14,786
12	Northwest Missouri State University	$5,535	$9,540
13	Eastern Connecticut State University	$5,964	$13,902
14	Francis Marion University	$5,984	$11,833
15	Lake Superior State University	$6,308	$12,296

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Fiscal Year 2005-06
Tuition and Fee Comparisons
for UNC Peer Institutions

	Institution name	Resident Tuition and Fees	Nonresident Tuition and Fees
1	**North Carolina A&T State University**	**$3,114**	**$12,556**
2	Florida A&M University	$3,188	$15,177
3	Jackson State University	$3,964	$8,872
4	Tennessee Technological University	$4,424	$13,736
5	University of Tennessee at Chattanooga	$4,500	$13,528
6	University of South Alabama	$4,502	$8,312
7	South Dakota State University	$4,732	$9,719
8	University of Texas at El Paso	$4,888	$13,218
9	Portland State University	$5,202	$17,127
10	Montana State University at Bozeman	$5,220	$14,859
11	North Dakota State University	$5,264	$12,545
12	University of Maine	$6,910	$17,050
13	Cleveland State University	$7,344	$13,056
14	Universityof Massachusetts at Dartmouth	$8,036	$17,638
15	New Jersey Inst of Technology	$9,822	$16,026

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Fiscal Year 2005-06
Tuition and Fee Comparisons
for UNC Peer Institutions

	Institution name	Resident Tuition and Fees	Nonresident Tuition and Fees
1	**North Carolina Central University**	**$3,146**	**$12,890**
2	Florida A&M University	$3,188	$15,177
3	University of West Florida	$3,198	$15,704
4	California State University at Bakersfield	$3,268	$13,438
5	Valdosta State University	$3,278	$10,594
6	West Texas A&M University	$3,756	$12,036
7	University of Houston--Clear Lake	$3,997	$12,277
8	Tennessee State University	$4,334	$13,646
9	University of Tennessee at Chattanooga	$4,500	$13,528
10	University of Colorado at Colorado Springs	$4,888	$16,182
11	Washburn University of Topeka	$4,982	$11,192
12	Salem State College	$5,594	$11,734
13	Edinboro University of Pennsylvania	$6,289	$11,197
14	Chicago State University	$6,625	$11,815
15	University of Texas at Dallas	$6,831	$15,111
16	New Jersey City University	$7,040	$12,080
17	Rutgers University at Camden	$8,778	$16,376

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Fiscal Year 2005-06
Tuition and Fee Comparisons
for UNC Peer Institutions

	Institution name	Resident Tuition and Fees	Nonresident Tuition and Fees
1	**North Carolina School of the Arts**	**$4,335**	**$15,615**
2	SUNY College at Purchase	$5,504	$11,764
3	Massachusetts College of Art	$6,850	$16,060
4	Columbia College	$11,625	--
5	Memphis College of Art	$17,460	--
6	Cornish College of the Arts	$21,200	--
7	Savannah College of Art and Design	$22,100	--
8	Milwaukee Inst of Art Design	$22,350	--
9	University of the Arts	$24,330	--
10	Juilliard School	$24,830	--
11	San Francisco Art Institute	$25,670	--
12	Cleveland Institute of Music	$26,870	--
13	Maryland Inst College of Art	$26,920	--
14	California Inst of the Arts	$27,735	--

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Fiscal Year 2005-06
Tuition and Fee Comparisons
for UNC Peer Institutions

	Institution name	Resident Tuition and Fees	Nonresident Tuition and Fees
1	University of Florida	$3,094	$16,579
2	**North Carolina State University**	**$4,338**	**$16,536**
3	University of Georgia	$4,628	$16,848
4	Georgia Inst of Technology	$4,648	$18,990
5	Iowa State University	$5,634	$15,724
6	University of Wisconsin at Madison	$6,280	$20,280
7	Virginia Tech	$6,378	$17,717
8	Texas A&M University at College Station	$6,399	$14,679
9	Purdue University	$6,458	$19,824
10	University of California at Davis	$7,457	$25,277
11	University of Maryland at College Park	$7,821	$20,145
12	Michigan State University	$7,880	$19,632
13	Ohio State University	$8,082	$19,305
14	University of Minnesota--Twin Cities	$8,622	$20,252
15	University of Illinois at Urbana-Champaign	$8,688	$22,774
16	Pennsylvania State University	$11,508	$21,744

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Fiscal Year 2005-06
Tuition and Fee Comparisons
for UNC Peer Institutions

	Institution name	Resident Tuition and Fees	Nonresident Tuition and Fees
1	University of Florida	$3,094	$16,579
2	**University of North Carolina at Chapel Hill**	**$4,515**	**$18,313**
3	University of Washington	$5,620	$19,917
4	University of Wisconsin at Madison	$6,280	$20,280
5	University of California at Los Angeles	$6,504	$24,324
6	University of California at Berkeley	$6,512	$24,332
7	U of Texas at Austin	$6,972	$16,310
8	University of Virginia	$7,133	$23,877
9	University of Illinois at Urbana-Champaign	$8,688	$22,774
10	University of Michigan at Ann Arbor	$9,213	$27,601
11	University of Pittsburgh	$11,436	$20,784

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Fiscal Year 2005-06
Tuition and Fee Comparisons
for UNC Peer Institutions

	Institution name	Resident Tuition and Fees	Nonresident Tuition and Fees
1	New College of Florida	$3,013	$15,520
2	**University of North Carolina at Asheville**	**$3,526**	**$13,326**
3	Evergreen State College	$4,284	$14,694
4	SUNY College at Geneseo	$5,520	$11,780
5	Massachusetts College of Liberal Arts	$5,617	$14,562
6	University of Mary Washington	$5,634	$14,776
7	Truman State University	$5,812	$9,992
8	Eastern Connecticut State University	$5,964	$13,902
9	Richard Stockton College of New Jersey	$7,870	$11,055
10	Ramapo College of New Jersey	$8,791	$13,708
11	University of Minnesota at Morris	$9,722	$9,722
12	St Mary's College of Maryland	$10,896	$19,773

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Fiscal Year 2005-06
Tuition and Fee Comparisons
for UNC Peer Institutions

	Institution name	Resident Tuition and Fees	Nonresident Tuition and Fees
1	University of Nevada at Las Vegas	$3,060	$12,527
2	San Diego State University	$3,122	$13,292
3	University of Central Florida	$3,359	$16,491
4	**University of North Carolina at Charlotte**	**$3,495**	**$13,907**
5	Georgia State University	$4,464	$15,378
6	Portland State University	$5,202	$17,127
7	University of Louisville	$5,532	$15,092
8	University of Texas at San Antonio	$5,544	$13,824
9	University of Texas at Arlington	$5,561	$13,843
10	George Mason University	$5,880	$19,770
11	University of Wisconsin at Milwaukee	$6,220	$18,972
12	Western Michigan University	$6,478	$15,856
13	University of Rhode Island	$7,284	$19,926
14	University of Delaware	$7,318	$17,474
15	Kent State University	$7,954	$15,386
16	University of Maryland--Baltimore County	$8,520	$16,596

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Fiscal Year 2005-06
Tuition and Fee Comparisons
for UNC Peer Institutions

	Institution name	Resident Tuition and Fees	Nonresident Tuition and Fees
1	Florida Atlantic University	$3,259	$15,765
2	**University of North Carolina at Greensboro**	**$3,467**	**$14,735**
3	University of Southern Mississippi	$4,310	$9,740
4	Georgia State University	$4,464	$15,378
5	University of Alabama at Huntsville	$4,688	$9,886
6	Portland State University	$5,202	$17,127
7	SUNNY at Binghamton	$5,826	$12,086
8	George Mason University	$5,880	$19,770
9	University of Wisconsin at Milwaukee	$6,220	$18,972
10	Western Michigan University	$6,478	$15,856
11	Northern Illinois University	$6,638	$11,699
12	University of Delaware	$7,318	$17,474
13	College of William and Mary	$7,723	$22,993
14	University of Massachusetts at Lowell	$8,166	$19,066
15	Ohio University	$8,235	$17,199
16	Bowling Green State University	$8,544	$16,174
17	Miami University (Ohio)	$21,487	$21,507

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Fiscal Year 2005-06
Tuition and Fee Comparisons
for UNC Peer Institutions

	Institution name	Resident Tuition and Fees	Nonresident Tuition and Fees
1	**University of North Carolina at Pembroke**	**$2,980**	**$12,420**
2	California State University--Stanislaus	$3,080	$13,250
3	Northeastern State University	$3,300	$8,100
4	Nicholls State University	$3,336	$8,836
5	Pittsburg State University	$3,562	$10,444
6	University of North Alabama	$4,282	$7,930
7	Morehead State University	$4,320	$11,480
8	University of Tennessee at Martin	$4,493	$13,547
9	Austin Peay State U	$4,635	$13,947
10	Southern Oregon University	$5,085	$16,059
11	Radford University	$5,130	$12,368
12	SUNY at Fredonia	$5,441	$11,701
13	Northwest Missouri State University	$5,535	$9,540
14	Westfield State College	$5,657	$11,737
15	Western Connecticut State University	$5,800	$13,739
16	Shippensburg University of Pennsylvania	$6,175	$13,535
17	Salisbury University	$6,376	$14,054
18	East Stroudsburg University of Pennyslvania	$6,376	$13,696
19	Plymouth State University	$7,028	$13,868

Source: The Chronicle of Higher Education. The information was compiled by the College Board as part of "The Annual Survey of Colleges of the College Board."

Fiscal Year 2005-06
Tuition and Fee Comparisons
for UNC Peer Institutions

	Institution name	Resident Tuition and Fees	Nonresident Tuition and Fees
1	Humboldt State University	$3,079	$13,249
2	Sonoma State University	$3,624	$13,794
3	**University of North Carolina at Wilmington**	**$3,639**	**$13,574**
4	California Polytechnic State U at San Luis Obispo	$4,246	$14,416
5	Murray State University	$4,428	$12,036
6	Western Washington University	$4,737	$13,896
7	University of Wisconsin at Eau Claire	$5,014	$15,060
8	University of Northern Iowa	$5,602	$13,214
9	Truman State University	$5,812	$9,992
10	James Madison University	$5,886	$15,322
11	College of Charleston	$6,668	$15,342
12	University of Texas at Dallas	$6,831	$15,111
13	Towson University	$7,096	$16,030
14	Rowan University	$8,606	$14,900
15	College of New Jersey	$9,707	$14,970

Source: The Chronicle of Higher Education. The information was compiled by the College Board as part of "The Annual Survey of Colleges of the College Board."

Fiscal Year 2005-06
Tuition and Fee Comparisons
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6	Western Washington University	$4,737	$13,896
7	University of Wisconsin at Eau Claire	$5,014	$15,060
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10	James Madison University	$5,886	$15,322
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Fiscal Year 2005-06
Tuition and Fee Comparisons
for UNC Peer Institutions

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5	Murray State University	$4,428	$12,036
6	Western Washington University	$4,737	$13,896
7	University of Wisconsin at Eau Claire	$5,014	$15,060
8	University of Northern Iowa	$5,602	$13,214
9	Truman State University	$5,812	$9,992
10	James Madison University	$5,886	$15,322
11	College of Charleston	$6,668	$15,342
12	University of Texas at Dallas	$6,831	$15,111
13	Towson University	$7,096	$16,030
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Fiscal Year 2005-06
Tuition and Fee Comparisons
for UNC Peer Institutions

	Institution name	Resident Tuition and Fees	Nonresident Tuition and Fees
1	Georgia Southern University	$3,462	$10,778
2	Sonoma State University	$3,624	$13,794
3	**Western Carolina University**	**$3,624**	**$13,060**
4	Murray State University	$4,428	$12,036
5	University of Wisconsin at Stevens Point	$4,928	$14,974
6	University of Wisconsin at La Crosse	$5,074	$15,120
7	Radford University	$5,130	$12,368
8	Western Kentucky University	$5,160	$12,576
9	SUNY College at Brockport	$5,293	$11,553
10	Winona State University	$5,661	$9,607
11	Northern Michigan University	$5,858	$9,602
12	James Madison University	$5,886	$15,322
13	Shippensburg University of Pennsylvania	$6,175	$13,535
14	Bloomsburg State University	$6,226	$13,586
15	Salisbury University	$6,376	$14,054
16	Towson University	$7,096	$16,030

Source: The Chronicle of Higher Education. The information was compiled by the College Board as part of "The Annual Survey of Colleges of the College Board."

Fiscal Year 2005-06
Tuition and Fee Comparisons
for UNC Peer Institutions

	Institution name	Resident Tuition and Fees	Nonresident Tuition and Fees
1	**Winston-Salem State University**	**$2,804**	**$11,444**
2	Armstrong Atlantic State University	$2,924	$10,240
3	Florida Gulf Coast University	$3,191	$15,287
4	University of Louisiana at Monroe	$3,353	$9,305
5	Jacksonville State University	$4,040	$8,080
6	Colorado State University at Pueblo	$4,118	$14,758
7	Georgia College& State University	$4,142	$14,354
8	University of North Alabama	$4,282	$7,930
9	Murray State University	$4,428	$12,036
10	University of Tennessee at Chattanooga	$4,500	$13,528
11	Radford University	$5,130	$12,368
12	University of Central Arkansas	$5,682	$10,182
13	University of Maryland--Eastern Shore	$5,808	$11,964
14	Lock Haven University of Pennsylvania	$6,258	$11,618
15	University of South Carolina Upstate	$6,762	$13,600
16	Longwood University	$6,840	$13,524
17	Winthrop University	$8,756	$16,150

Source: The Chronicle of Higher Education. The information was compiled by the College Board as part of "The Annual Survey of Colleges of the College Board."

Total and current expenditures per pupil in public elementary and secondary education - 2002-03

	Expenditure per pupil in fall enrollment		Expenditure per pupil in average daily attendance	
	Total Expenditure	Current Expenditure	Total Expenditure	Current Expenditure
Alabama	7,031	6,300	7,565	6,642
Arkansas	7,275	6,482	7,891	6,981
Florida	7,773	6,439	8,533	6,922
Georgia	9,041	7,774	9,705	8,308
Louisiana	7,638	6,922	8,341	7,492
Mississippi	6,356	5,792	6,842	6,186
North Carolina	7,529	6,562	8,134	7,057
South Carolina	8,577	7,040	9,569	7,759
Tennessee	6,962	6,118	7,644	6,674
Virginia	8,854	7,822	9,452	8,300
California	8,740	7,552	8,957	7,601
Illinois	9,851	8,287	11,134	9,309
Maryland	10,051	9,153	10,791	9,801
Minnesota	9,907	8,109	10,717	8,440
New Hampshire	9,802	8,579	10,200	8,900
New Jersey	13,884	12,568	14,604	13,093
Texas	8,598	7,136	9,364	7,714
United States	9,299	8,044	10,094	8,600

U.S. Department of Education, Institute of Education Sciences, National Center for Education Statistics, Digest of Education Statistics Tables and Fig
and Secondary Education, Enrollment: Table 37 - Average Daily Attendance in Public Elementary and Secondary Schools, by State or Jurisdiction: Se
2002-03; Revenues and Expenditures: Table 158 - Total Expenditures for Public Elementary and Secondary Education, by Function and State or Juris
Total and Current Expenditures Per Pupil in Fall Enrollment in Public Elementary and Secondary Education, by Function and State or Jurisdiction: 200
Expenditure Per Pupil in Average Daily Attendance in Public Elementary and Secondary Schools, by State or Jurisdiction: Selected Years, 1959-60 th
http://nces.ed.gov/programs/digest/d05_tf.asp

ures: 2005. Chapter 2, Elementary
lected Years, 1969-70 through
diction: 2002-03, Table 164 -
2-03, Table 167 - Current
ough 2002-03.

Per Pupil Amounts for Current Spending of Public Elementary-Secondary School Systems by State: 2003-04

Geographic area				Instruction			Support services				
	Total [1]	Salaries and wages	Employee benefits	Total [1]	Salaries and wages	Employee benefits	Total [1]	Pupil support	Staff support	General ministration	School ministration
United States	8,287	5,257	1,564	5,056	3,561	1,035	2,892	434	396	166	467
Alabama	6,553	4,021	1,272	3,934	2,708	808	2,164	320	277	176	398
Alaska	10,114	5,931	1,806	5,821	3,864	1,143	3,960	651	491	152	590
Arizona	6,036	3,900	924	3,458	2,568	597	2,269	375	165	88	313
Arkansas	6,740	4,349	994	4,105	2,921	659	2,285	307	353	222	374
California	7,748	4,993	1,507	4,690	3,276	919	2,774	345	478	70	520
Colorado	7,412	4,842	988	4,265	3,146	623	2,895	331	373	104	490
Connecticut	10,788	6,937	2,010	6,714	4,896	1,403	3,661	634	388	223	624
Delaware	10,228	6,015	2,215	6,300	4,237	1,563	3,530	502	132	115	588
District of Columbia	12,801	8,237	968	6,337	4,593	435	6,111	957	764	348	761
Florida	6,784	4,201	1,203	4,015	2,630	721	2,436	335	420	77	402
Georgia	7,733	5,185	1,421	4,922	3,590	1,011	2,414	358	406	103	466
Hawaii	8,533	5,352	1,537	5,139	3,487	1,000	2,968	944	455	60	540
Idaho	6,028	3,811	1,211	3,742	2,640	816	2,014	331	241	142	348
Illinois	8,656	5,387	1,715	5,195	3,690	1,090	3,170	536	342	303	469
Indiana	8,280	4,839	2,263	4,977	3,266	1,557	2,970	374	282	161	469
Iowa	7,631	5,158	1,539	4,689	3,366	987	2,570	476	346	216	422
Kansas	7,518	4,661	1,084	4,539	3,061	703	2,618	350	321	241	453
Kentucky	6,888	4,639	1,272	4,103	3,063	802	2,380	282	358	179	387
Louisiana	7,209	4,555	1,390	4,349	3,067	922	2,417	317	344	166	385
Maine	9,534	5,850	2,121	6,270	4,182	1,562	2,941	330	320	210	532

Maryland	9,212	5,917	1,934	5,711	4,050	1,352	3,076	344	581	85	552
Massachusetts	10,693	6,659	2,353	6,669	4,568	1,732	3,697	695	701	150	480
Michigan	9,072	5,360	2,162	5,182	3,428	1,361	3,608	638	441	196	552
Minnesota	8,359	5,549	1,525	5,444	3,873	1,079	2,522	268	383	209	356
Mississippi	6,237	3,904	1,057	3,718	2,635	687	2,102	280	291	198	346
Missouri	7,331	4,854	1,137	4,433	3,263	737	2,574	367	330	232	434
Montana	7,763	4,601	1,298	4,752	3,158	873	2,705	399	303	242	429
Nebraska	8,032	4,910	1,437	5,163	3,427	1,030	2,498	353	279	280	428
Nevada	6,399	3,962	1,292	4,008	2,627	865	2,179	243	243	110	439
New Hampshire	8,860	5,437	1,686	5,588	3,989	1,235	2,985	626	283	311	517
New Jersey	12,981	7,963	2,577	7,524	5,243	1,627	5,035	1,267	469	346	672
New Mexico	7,331	4,582	1,281	4,149	2,966	811	2,828	724	334	190	452
New York	12,930	8,076	2,629	8,840	6,082	2,063	3,789	417	349	266	577
North Carolina	6,702	4,623	906	4,177	3,174	602	2,146	372	225	115	454
North Dakota	7,727	4,845	1,297	4,727	3,389	915	2,445	299	223	358	367
Ohio	8,963	5,648	1,846	5,105	3,593	1,102	3,552	545	580	243	513
Oklahoma	6,176	3,636	939	3,423	2,413	617	2,318	406	259	188	334
Oregon	7,619	4,336	1,838	4,499	2,896	1,166	2,848	510	288	111	489
Pennsylvania	9,979	5,981	1,894	6,049	4,182	1,264	3,546	493	374	313	426
Rhode Island	9,903	6,529	2,343	6,048	4,684	1,670	3,576	856	470	145	583
South Carolina	7,184	4,518	1,283	4,239	3,036	840	2,556	519	460	90	414
South Dakota	6,949	4,291	1,105	4,169	2,959	744	2,452	367	323	244	336
Tennessee	6,504	4,235	1,051	4,216	2,982	704	1,971	231	331	128	350
Texas	7,104	4,903	834	4,286	3,317	528	2,463	350	396	113	396
Utah	5,008	3,114	1,168	3,187	2,151	805	1,517	179	236	57	307
Vermont	11,128	6,793	2,155	6,920	4,768	1,510	3,882	853	423	287	805
Virginia	8,225	5,604	1,474	5,041	3,723	963	2,855	398	515	124	482
Washington	7,243	4,827	1,152	4,356	3,194	732	2,526	459	327	99	437

West Virginia.....	8,475	4,908	2,428	5,197	3,331	1,607	2,797	287	243	240	458
Wisconsin.....	9,226	5,169	2,427	5,644	3,682	1,625	3,255	412	450	255	478
Wyoming.....	9,363	5,761	1,940	5,568	3,776	1,243	3,497	555	464	216	526

Elementary-Secondary Education Statistics Branch
Governments Division
U.S. Census Bureau

	[Capital Funding Sources]			[Misc County Capital Fund Sources for Public Schools]					
Geographic Area	**Estimated Lottery Distribution - 9/15/06 (?) - Allocated for Capital Projects for School Construction Projects (115C-546.2(d))**			**October 2006 Lottery Distribution**			**[Sources of County Funding for Public School Capital Outlays - Restricted Local Option Sales Taxes - 2004-05)]**		
	To All LEA's	35% to Eligible LEA's under 115C-546.2	Total	To All LEA's	35% to Eligible LEA's under 115C-546.2	Total	Article 40 (105-487) 30% Resticted	Article 42 (105-502) 60% Restricted	Total
Alamance	1,740,224	N/A	1,740,224	388,991	N/A	388,991	1,287,113	2,552,145	3,839,258
Ashe	260,475	N/A	260,475	58,224	N/A	58,224	326,491	648,541	975,032
Buncombe	2,028,296	N/A	2,028,296	453,384	N/A	453,384	N/A	N/A	N/A
Asheville	301,752	N/A	301,752	67,450	N/A	67,450	N/A	N/A	N/A
Buncombe-Asheville	2,330,048	N/A	2,330,048	520,834	N/A	520,834	2,166,745	4,280,481	6,447,226
Carteret	665,065	N/A	665,065	148,662	N/A	148,662	716,696	1,416,107	2,132,803
Catawba	1,357,177	N/A	1,357,177	303,369	N/A	303,369	N/A	N/A	N/A
Hickory	356,316	N/A	356,316	79,647	N/A	79,647	N/A	N/A	N/A
Newton-Conover	233,665	N/A	233,665	52,231	N/A	52,231	N/A	N/A	N/A
Catawba-Hickory-Newton-Conover	1,947,158	N/A	1,947,158	435,247	N/A	435,247	1,469,896	2,908,906	4,378,802
Forsyth	3,994,324	3,709,609	7,703,933	892,849	829,207	1,722,056	3,089,854	6,020,757	9,110,611
Montgomery	357,417	N/A	357,417	79,893	N/A	79,893	297,293	592,017	889,310
Northampton	243,729	226,356	470,085	54,481	50,597	105,078	250,999	500,831	751,830
Robeson	1,908,161	1,772,148	3,680,309	426,530	396,127	822,657	1,487,423	2,958,300	4,445,723
Wake	9,993,986	N/A	9,993,986	2,233,950	N/A	2,233,950	5,695,354	11,245,960	16,941,314
North Carolina	110,500,000	59,500,000	170,000,000	24,700,000	13,300,000	38,000,000	94,625,989	175,351,652	269,977,641

Figures for Lottery Distribution from Public Schools of North Carolina, State Board of Education Department of Public Instruction, Financial & Business Services, (http://www.ncpublicschools.org/fbs/), Revised Estimated Lottery Distribution (Q:\Bud\School Allotments\Special Projects\Other_Lottery\lotterydistribution_Frozer October 2006 Lottery Distribution (accessed at School Planning, Dept. of Public Instruction, Public School Building Capital Fund, Lottery Fund Distribution, 10/19

Figures for the Sales Taxes and the Public School Building Capital Fund from Department of State Treasurer, State and Local Government Finance Division and Commission Memorandum #1055: Report on County Spending on Public School Capital Outlay, April 25, 2006. http://www.nctreasurer.com/NR/rdonlyres/28C6A FB77D2E0B76D/0/Memo1055.pdf

Public School Building Capital Fund (105-130.3, 115C-546.1, 115C-546.2) - From Corporate Income Tax (only - until arrival of lottery funds??) 2004-05
930,590
0
437,552
N/A
437,552
350,000
1,393,661
N/A
N/A
1,393,661
930,287
0
0
0
0
40,881,721
School Allotments Section SA_09-15-06.xls) and /06 -
the Local Government 687-60FA-4DFF-A530-

N[illegible]arolina Association of County Commissioners
Required School Capital Funding

County	2005-06 Article 40 (30% of distr.) sales tax	2005-06 Article 42 (60% of distr.) sales tax	Projected 2006-07 Lottery Proceeds	2005-06 ADM Fund Allocation	Total School Required Capital Funding	2005-06 County School Capital Appropr	2004-05 County School Capital Appropr	2003-04 County School Capital Appropr	5 year Required Capital Funding	2005-06 Survey of 5 year School Capital Needs	Percent School Facility Survey Needs Supported by Required Funding
Alamance	1,287,113	2,552,145	1,740,224	1,691,186	7,270,668	5,660,080	6,211,438	4,801,210	36,353,342	71,563,432	51%
Alexander	488,169	972,711	453,414	428,896	2,343,190	1,835,642	1,492,350	1,516,320	11,715,952	1,102,264	1063%
Alleghany	141,773	282,097	121,943	110,073	655,886	552,094	1,393,847	1,494,410	3,279,429	9,119,739	36%
Anson	269,047	536,279	639,922	311,402	1,756,650	1,328,196	1,113,376	1,314,045	8,783,248	9,016,614	97%
Ashe	326,491	648,541	260,475	269,743	1,505,250	2,328,626	2,168,656	4,610,979	7,526,249	3,241,968	232%
Avery	285,763	566,585	180,281	179,436	1,212,065	2,206,148	2,364,178	2,442,345	6,060,323	15,030,087	40%
Beaufort	551,466	1,094,392	569,225	621,906	2,836,989	2,396,270	1,770,774	1,745,665	14,184,947	24,656,520	58%
Bertie	229,164	456,937	492,376	275,149	1,453,626	899,971	718,350	572,500	7,268,129	35,980,002	20%
Bladen	416,279	829,157	841,603	403,274	2,490,313	2,995,664	2,452,114	2,452,514	12,451,564	81,925,796	15%
Brunswick	1,020,927	2,018,958	904,942	864,334	4,809,161	10,618,709	10,216,443	8,217,383	24,045,804	45,679,566	53%
Buncombe	2,166,745	4,280,481	2,330,048	2,193,335	10,970,609	18,872,285	16,477,607	18,833,393	54,853,047	10,636,266	516%
Burke	5,121,956	1,993,874	1,136,642	1,127,674	9,380,146	7,714,000	6,515,000	6,367,000	46,900,730	76,609,349	61%
Cabarrus	1,408,883	2,786,364	4,356,322	2,081,571	10,633,140	24,102,285	20,400,884	17,016,515	53,165,702	216,733,056	25%
Caldwell	796,236	1,584,054	1,022,639	968,103	4,371,032	2,789,228	3,236,122	3,356,040	21,855,161	44,987,094	49%
Camden	106,941	191,765	292,211	133,007	723,924	126,000	1,516,549	1,293,313	3,619,621	33,973,834	11%
Carteret	716,696	1,416,107	665,065	627,984	3,425,852	7,880,850	6,649,790	6,592,177	17,129,262	49,536,334	35%
Caswell	323,495	645,777	260,318	265,507	1,495,097	1,359,217	1,394,066	1,446,138	7,475,485	13,739,921	54%
Catawba	1,469,896	2,908,906	1,947,158	1,747,397	8,073,357	17,338,499	21,206,916	14,989,786	40,366,786	121,336,597	33%
Chatham	685,907	1,364,690	1,150,495	590,682	3,791,774	4,086,024	3,501,157	3,388,918	18,958,868	80,575,549	24%
Cherokee	325,567	644,899	293,418	272,710	1,536,594	1,972,779	1,754,918	2,082,425	7,682,968	19,768,417	39%
Chowan	195,138	389,147	377,888	180,188	1,142,361	1,552,496	1,708,073	1,906,127	5,711,805	20,267,256	28%
Clay	117,846	223,986	106,061	96,690	544,583	281,223	416,170	417,207	2,722,915	3,568,805	76%
Cleveland	948,859	1,886,980	2,591,380	1,223,452	6,650,671	5,251,979	5,210,000	4,474,035	33,253,354	110,432,636	30%
Columbus	533,888	1,005,308	1,475,461	708,010	3,722,667	1,335,000	1,718,528	2,687,130	18,613,337	184,937,673	10%
Craven	1,020,050	2,024,769	1,164,238	1,053,235	5,262,292	3,810,000	3,800,000	4,015,000	26,311,460	90,976,125	29%
Cumberland	3,008,337	5,965,065	7,951,713	3,713,924	20,639,039	9,000,000	9,000,000	17,301,010	103,195,194	133,343,220	77%
Currituck	288,850	569,118	332,336	289,767	1,480,071	3,501,532	2,782,877	3,295,803	7,400,354	26,462,259	28%
Dare	546,298	1,058,306	391,381	407,653	2,403,638	15,257,248	10,608,863	9,212,982	12,018,189	24,908,995	48%
Davidson	1,663,712	3,309,630	2,055,971	1,910,725	8,940,038	7,259,394	7,371,758	4,060,382	44,700,191	85,391,748	52%
Davie	442,903	877,353	514,897	470,093	2,305,246	4,185,615	3,112,954	2,518,850	11,526,232	52,415,490	22%
Duplin	613,449	1,221,140	1,375,681	636,964	3,847,234	2,396,060	2,253,413	2,240,975	19,236,170	70,933,583	27%
Durham	2,153,087	4,256,728	4,817,914	2,509,565	13,737,294	18,811,950	19,716,095	18,960,818	68,686,471	348,040,381	20%
Edgecombe	518,711	1,031,794	1,153,982	562,220	3,266,707	1,359,633	1,429,630	1,450,025	16,333,537	38,485,777	42%
Forsyth	3,089,854	6,020,757	7,703,933	3,793,946	20,608,490	26,881,595	24,551,769	21,319,014	103,042,448	312,932,284	33%
Franklin	691,274	1,376,264	1,230,712	602,781	3,901,031	4,228,328	4,117,504	4,456,087	19,505,157	63,710,088	31%
Gaston	2,110,968	4,192,072	4,901,165	2,383,848	13,588,053	9,404,649	9,014,784	8,547,740	67,940,267	417,018,324	16%
Gates	149,658	298,732	320,264	149,177	917,831	632,730	694,100	694,100	4,589,155	26,785,893	17%
Graham	110,963	220,801	96,391	94,214	522,369	411,647	415,647	397,935	2,611,843	3,475,261	75%
Granville	655,808	1,305,947	1,335,041	654,064	3,950,860	7,099,811	3,507,357	2,606,716	19,754,302	30,242,531	65%
Greene	265,290	529,149	500,262	231,271	1,525,972	919,000	765,648	785,649	7,629,859	46,560,606	16%
Guilford	3,626,150	7,166,324	10,611,635	5,095,655	26,499,764	36,001,158	31,041,961	28,983,075	132,498,820	474,829,236	28%
Halifax	650,661	1,293,579	1,362,792	663,899	3,970,931	3,873,438	3,755,407	4,753,508	19,854,656	83,962,447	24%
Harnett	1,236,654	2,462,222	2,782,750	1,356,640	7,838,266	950,000	5,323,421	6,992,103	39,191,328	222,159,530	18%
Haywood	659,526	1,307,435	620,093	584,841	3,171,895	3,348,220	3,453,210	3,328,460	15,859,475	20,731,608	76%
Henderson	1,137,029	2,253,829	1,025,155	931,080	5,347,093	7,863,423	6,934,439	7,314,544	26,735,463	44,303,315	60%
Hertford	289,547	574,999	538,475	280,028	1,683,049	1,944,000	920,166	1,064,000	8,415,244	11,231,171	75%
Hoke	552,203	768,317	1,110,613	508,983	2,940,116	1,094,665	2,512,554	1,041,171	14,700,581	95,558,910	15%
Hyde	83,619	166,021	50,240	50,954	350,834	247,500	220,000	200,000	1,754,172	16,777,793	10%
Iredell	1,450,151	2,867,629	2,048,974	1,887,521	8,254,275	15,442,016	14,108,372	14,211,400	41,271,376	175,000,416	24%
Jackson	515,620	1,022,414	292,396	287,028	2,117,458	4,204,633	3,475,149	3,373,355	10,587,290	7,488,841	141%
Johnston	3,444,840	3,418,519	4,385,892	2,009,368	13,258,619	25,054,174	25,013,268	19,734,990	66,293,097	221,503,405	30%
Jones	128,383	256,121	204,108	111,943	700,555	419,213	430,800	267,600	3,502,776	36,241,477	10%

North Carolina Association of County Commissioners
Required School Capital Funding

County	2005-06 Article 40 (30% of distr.) sales tax	2005-06 Article 42 (60% of distr.) sales tax	Projected 2006-07 Lottery Proceeds	2005-06 ADM Fund Allocation	Total School Required Capital Funding	2005-06 County School Capital Appropr	2004-05 County School Capital Appropr	2003-04 County School Capital Appropr	5 year Required Capital Funding	2005-06 Survey of 5 year School Capital Needs	Percent School Facility Survey Needs Supported by Required Funding
Lee	478,174	947,547	1,410,406	671,564	3,507,691	4,599,267	4,954,965	3,080,528	17,538,456	40,163,450	44%
Lenoir	630,061	1,224,352	1,503,058	821,137	4,178,608	1,620,000	1,727,000	1,775,000	20,893,040	93,228,111	22%
Lincoln	842,903	1,675,243	957,933	888,227	4,364,306	8,583,767	7,932,457	7,200,348	21,821,529	54,306,261	40%
Macon	400,668	791,840	344,916	306,202	1,843,626	1,720,000	4,037,569	3,464,184	9,218,128	41,362,270	22%
Madison	245,660	489,798	207,248	207,918	1,150,624	621,532	185,586	622,703	5,753,119	38,814,846	15%
Martin	314,118	607,198	655,844	405,829	1,982,989	960,000	960,000	960,000	9,914,944	45,228,518	22%
McDowell	600,267	1,194,292	510,494	494,642	2,799,695	2,230,000	2,212,000	2,321,450	13,998,476	3,260,424	429%
Mecklenburg	6,749,220	13,293,940	19,465,607	9,139,412	48,648,179	114,948,183	101,493,987	89,108,685	243,240,896	910,009,429	27%
Mitchell	199,697	396,543	179,495	172,209	947,944	-	-	-	4,739,718	2,777,874	171%
Montgomery	297,293	592,017	357,417	363,964	1,610,691	1,491,635	1,728,639	728,280	8,053,455	86,205,126	9%
Moore	894,721	1,772,252	957,540	888,295	4,512,808	5,227,950	5,451,500	5,602,874	22,564,042	82,115,165	27%
Nash	771,561	1,527,217	2,754,546	1,423,070	6,476,394	3,041,824	2,594,936	2,873,782	32,381,969	131,087,232	25%
New Hanover	1,909,376	3,758,707	1,951,639	1,800,583	9,420,305	18,428,094	19,941,175	18,848,586	47,101,523	103,198,295	46%
Northampton	250,999	500,831	470,085	256,070	1,477,985	1,450,211	925,753	1,103,803	7,389,923	13,347,424	55%
Onslow	1,630,498	3,236,528	1,838,817	1,719,963	8,425,806	8,066,681	7,658,526	7,654,658	42,129,029	253,279,258	17%
Orange	1,525,355	2,562,526	2,724,672	1,277,212	8,089,765	21,430,394	19,220,358	17,916,629	40,448,825	92,091,567	44%
Pamlico	174,003	346,651	243,686	156,629	920,969	594,708	184,828	611,245	4,604,844	6,577,658	70%
Pasquotank	412,946	817,981	491,389	429,364	2,151,680	3,702,396	2,592,315	2,597,228	10,758,402	37,819,285	28%
Pender	567,058	1,128,694	599,652	537,972	2,833,376	3,670,275	3,234,975	3,850,251	14,166,881	60,247,227	24%
Perquimans	150,588	300,191	143,407	151,195	745,381	2,349,740	2,012,532	702,682	3,726,906	23,296,428	16%
Person	467,062	928,551	887,096	472,249	2,754,958	2,431,411	3,181,611	3,064,958	13,774,791	4,605,600	299%
Pitt	1,366,173	2,706,929	3,411,148	1,558,680	9,042,930	8,763,332	6,508,553	7,974,198	45,214,649	185,419,018	24%
Polk	237,145	475,233	198,678	182,783	1,093,839	1,269,037	1,315,572	1,908,305	5,469,197	5,932,863	92%
Randolph	1,463,829	2,911,866	1,851,474	1,718,442	7,945,611	11,292,248	11,308,263	11,265,560	39,728,056	161,182,495	25%
Richmond	544,520	1,082,424	1,270,139	618,017	3,515,100	1,850,000	2,252,714	1,735,000	17,575,500	73,732,257	24%
Robeson	1,487,423	2,958,300	3,680,309	1,889,502	10,015,534	5,480,685	5,910,524	5,294,539	50,077,669	No report	
Rockingham	977,614	1,944,953	2,208,034	1,103,369	6,233,970	5,095,013	4,346,748	3,884,775	31,169,852	67,495,567	46%
Rowan	1,292,166	2,568,687	3,340,483	1,571,633	8,772,969	10,747,961	6,681,295	7,175,814	43,864,845	124,059,800	35%
Rutherford	774,758	1,540,795	785,829	783,673	3,885,055	5,138,956	4,890,131	4,852,894	19,425,276	14,569,342	133%
Sampson	810,199	1,612,551	1,723,241	813,610	4,959,601	4,487,037	2,759,101	3,155,400	24,798,003	148,051,534	17%
Scotland	444,366	882,946	1,042,982	507,342	2,877,636	1,643,940	1,687,980	1,894,279	14,388,180	68,162,922	21%
Stanly	590,779	1,173,695	1,461,964	753,374	3,979,812	3,894,525	3,934,176	3,973,425	19,899,058	38,305,910	52%
Stokes	623,836	1,243,663	1,121,684	557,962	3,547,145	4,150,596	4,547,583	4,198,723	17,735,726	49,476,804	36%
Surry	928,299	1,842,101	1,801,032	898,015	5,469,447	4,670,692	4,713,832	3,999,221	27,347,234	53,981,691	51%
Swain	182,980	364,188	147,967	140,863	835,998	753,783	753,485	648,065	4,179,990	17,106,052	24%
Transylvania	416,328	825,733	303,325	290,290	1,835,676	4,350,280	4,013,423	3,956,818	9,178,379	8,486,908	108%
Tyrrell	59,009	117,535	94,472	52,163	323,179	262,275	115,350	115,350	1,615,894	1,023,232	158%
Union	1,524,207	3,026,037	2,671,740	2,224,376	9,446,360	32,425,871	25,732,964	18,592,164	47,231,798	231,713,620	20%
Vance	544,643	1,081,632	1,236,323	614,919	3,477,517	2,044,862	2,110,978	1,790,428	17,387,585	47,797,694	36%
Wake	5,695,354	11,245,960	9,993,986	8,901,290	35,836,590	110,155,508	107,511,322	103,068,916	179,182,952	1,447,959,585	12%
Warren	263,297	525,259	442,487	238,704	1,469,747	963,436	1,130,540	1,206,008	7,348,733	13,878,289	53%
Washington	182,646	363,504	328,908	170,418	1,045,476	550,650	540,000	534,500	5,227,382	25,142,146	21%
Watauga	493,783	973,960	355,530	372,432	2,195,705	5,234,522	3,238,467	3,047,033	10,978,524	58,233,332	19%
Wayne	1,155,942	2,295,096	2,920,744	1,439,115	7,810,897	5,039,076	5,034,271	5,406,833	39,054,483	218,758,614	18%
Wilkes	504,721	1,408,839	797,229	754,776	3,465,565	3,036,582	2,926,063	2,829,188	17,327,825	3,714,840	466%
Wilson	778,531	1,530,377	1,912,942	960,221	5,182,071	5,882,693	5,853,877	5,467,256	25,910,356	23,965,255	108%
Yadkin	488,555	973,980	950,178	479,880	2,892,593	1,652,993	1,547,755	1,317,261	14,462,964	73,233,988	20%
Yancey	244,818	487,336	203,710	199,659	1,135,523	688,500	675,000	675,000	5,677,615	17,249,511	33%
Total	94,625,989	175,351,652	170,000,000	102,982,309	542,959,950	789,778,018	736,209,131	691,199,694	2,714,799,752	9,767,544,206	28%

North Carolina Association of County Commissioners
County Expenditures for Education and Human Services

Description	Expenditure	Elementary & secondary	Percent of Exps.	Public welfare	Percent of Exps.	Health	Percent of Exps.
United States	266,485,493	36,468,389	13.7%	29,546,613	11.1%	20,656,210	7.8%
Alabama	2,046,939	1,732	0.1%	42,393	2.1%	95,750	4.7%
Arizona	3,768,403	39,787	1.1%	503,162	13.4%	192,184	5.1%
Arkansas	931,261	32	0.0%	13,790	1.5%	6,855	0.7%
California	53,350,126	3,251,515	6.1%	12,082,550	22.6%	5,892,801	11.0%
Colorado	2,544,360	3,941	0.2%	394,800	15.5%	130,767	5.1%
Connecticut							
Delaware	317,556			290	0.1%	15,497	4.9%
Florida	19,012,863	1,868	0.0%	443,624	2.3%	434,639	2.3%
Georgia	7,196,663	56	0.0%	130,286	1.8%	350,896	4.9%
Hawaii	593,241	25	0.0%	29,548	5.0%	12,747	2.1%
Idaho	820,045	59	0.0%	31,665	3.9%	56,908	6.9%
Illinois	5,713,605	7,174	0.1%	249,943	4.4%	308,541	5.4%
Indiana	4,399,144	118	0.0%	400,513	9.1%	75,899	1.7%
Iowa	2,022,730	154	0.0%	101,092	5.0%	255,745	12.6%
Kansas	1,881,333	156	0.0%	27,668	1.5%	136,595	7.3%
Kentucky	2,219,879	503	0.0%	25,799	1.2%	286,263	12.9%
Louisiana	3,803,639	30,561	0.8%	41,598	1.1%	71,910	1.9%
Maine	108,639			647	0.6%	177	0.2%
Maryland	14,889,038	8,190,692	55.0%	104,649	0.7%	176,194	1.2%
Massachusetts	322,267	12,792	4.0%	626	0.2%	3,693	1.1%
Michigan	8,890,616			758,459	8.5%	2,127,525	23.9%
Minnesota	4,999,437			1,331,529	26.6%	366,060	7.3%
Mississippi	2,121,792	4,094	0.2%	16,277	0.8%	37,590	1.8%
Missouri	1,907,161	621	0.0%	42,381	2.2%	98,619	5.2%
Montana	548,013	1,838	0.3%	26,915	4.9%	29,953	5.5%
Nebraska	942,692	409	0.0%	29,920	3.2%	19,503	2.1%
Nevada	3,868,430			113,887	2.9%	69,954	1.8%

New Hampshire	306,207	21	0.0%	135,161	44.1%		
New Jersey	6,311,897	719,399	11.4%	898,872	14.2%	202,489	3.2%
New Mexico	836,860			36,201	4.3%	15,840	1.9%
New York	18,985,207	261,598	1.4%	3,260,206	17.2%	1,186,024	6.2%
North Carolina	12,483,571	3,540,886	28.4%	1,134,102	9.1%	1,356,177	10.9%
North Dakota	301,265	359	0.1%	37,211	12.4%	12,639	4.2%
Ohio	11,225,333			2,541,875	22.6%	1,850,341	16.5%
Oklahoma	1,030,069	1,192	0.1%	3,770	0.4%	39,975	3.9%
Oregon	2,893,931	4,357	0.2%	246,268	8.5%	542,235	18.7%
Pennsylvania	6,923,176	9,500	0.1%	1,887,129	27.3%	1,264,320	18.3%
Rhode Island							
South Carolina	2,589,976			12,170	0.5%	134,599	5.2%
South Dakota	271,118			8,520	3.1%	7,140	2.6%
Tennessee	8,963,593	4,586,512	51.2%	93,052	1.0%	190,681	2.1%
Texas	10,817,018	470	0.0%	186,768	1.7%	617,763	5.7%
Utah	1,075,630			21,726	2.0%	120,400	11.2%
Vermont	4,632						
Virginia	12,954,467	7,952,196	61.4%	637,476	4.9%	421,248	3.3%
Washington	4,444,194	8,450	0.2%	39,418	0.9%	593,842	13.4%
West Virginia	625,252	125	0.0%	1,745	0.3%	33,173	5.3%
Wisconsin	5,407,302	63,386	1.2%	1,411,048	26.1%	781,229	14.4%
Wyoming	645,087			4,264	0.7%	15,509	2.4%

Federal, State, and Local Governments
State and Local Government Finances
2002 Census of Governments

NC adjusted to eliminate school board expenditures

EXECUTIVE SUMMARY
COSTS ESTIMATES FOR NEW BUSINESS COURTS
2007- 09 BIENNIUM - EFFECTIVE DATE 7/1/07

I. NEW BUSINESS COURT IN AN EXISTING COURT FACILITY

DESCRIPTION	FY 2007- 08	FY 2008- 09
RECURRING COSTS	$135,827	$136,558
NONRECURRING COSTS	$150,614	$0
TOTAL REQUIREMENTS:	$286,441	$136,558
NEW POSITIONS EST'ED:	2.00	2.00
ADDITIONAL COSTS IF A REPLACEMENT SUPERIOR COURT JUDGE IS REQUIRED:	$174,383	$162,546
SCJ ADJUSTED REQUIREMENTS:	$460,824	$299,104

II. BUSINESS COURT IN A NEW COURT FACILITY

DESCRIPTION	FY 2007- 08	FY 2008- 09
RECURRING COSTS	$217,827	$218,558
NONRECURRING COSTS	$280,614	$0
TOTAL REQUIREMENTS:	$498,441	$218,558
NEW POSITIONS EST'ED:	2.00	2.00
ADDITIONAL COSTS IF A REPLACEMENT SUPERIOR COURT JUDGE IS REQUIRED:	$174,383	$162,546
SCJ ADJUSTED REQUIREMENTS:	$672,824	$381,104

NOTES

(1) See the attached detail for Business Court models that are based on the proposed 2005 expansion of the Court into Mecklenburg and Wake Counties.
(2) The above and attached cost estimates are subject to change once a specific expansion site is selected, and the actual court site preparation requirements can be determined.
(3) The above costs do not include any salary or benefit adjustments that may be enacted by the upcoming 2007 General Assembly.

Prepared by Bob Boswell of the AOC's Financial Services Division.

BUDGET CODE: 12000 DEPARTMENT: THE N.C. JUDICIAL BRANCH
FUNDS: 1300-1230, 1100, & 1500 MAIN TITLE: TRIAL COURTS - SUPERIOR COURT

TITLE OF REQUEST: BUSINESS COURT IN EXISTING COURT FACILITY

LEGISLATIVE CHANGES/ADDITIONS REQUIRED TO IMPLEMENT? YES_X___NO_____

DETAIL DAS OBJECT				WHOLE DOLLARS 2007-08	WHOLE DOLLARS 2008-09
Objective:	This proposal is to add a new Business Court to be established in an existing Court Facility.				
1300 1230	Trial Courts - Superior Court	07-08	08-09		
531111	EPA-Reg. Salaries - Approp. - Effective 7/01/07			$81,799	$81,799
	1 (FR) Business Court Legal Assistant (RA's)	$43,635	$43,635		
	1 (FR) Business Court Judicial Assistant II	$38,164	$38,164		
531511	Social Security Contributions			$6,259	$6,259
531521	Retirement Contributions			$5,841	$5,841
531561	Hospital Insurance Contributions			$7,708	$7,708
532714	Transportation-Ground In-State (Training)			$485	$485
532721	Lodging - In-State (Training)			$299	$299
532724	Meals - In-State (Training)			$160	$160
532821	Computer/Data Processing Services (CLR)			$720	$720
532821	Computer/Data Processing Services (Case Management Licensing)		N/R	$26,000	$0
532840003	Postage/Postage Meter			$426	$460
1100	Administration & Services				
532430	Maintenance Agreements - Equipment (Copier)			$1,878	$1,972
532430	Maintenance Agreements - Equipment (Telecommunications)			$100	$104
532447	Maintenance Agreements - PC's & Printers			$186	$230
532448	Maintenance Agreements for PC Software			$0	$0
532449	Maintenance Agreements for Server Software (Help Desk)			$20,000	$20,000
532811	Telephone Service			$2,010	$2,093
532812	Telecom. Data Charges - Network Connections			$1,134	$1,300
532930	Registration & Training Fees			$1,060	$1,060
535890	Other Administrative Expense			$1,000	$1,000
1500 2008	Equipment & Other Reserves - Equipment & Supply Purchases - 2007-08				
1500 2009	Equipment & Other Reserves - Equipment & Supply Purchases - 2007-09			RCC 2008	RCC 2009
533110	Office Supplies & Materials (Includes Copier, FAX, Laser Printer)			$4,078	$4,351
534521	Office Equipment		N/R	$20,659	$0
	2 Executive Desks (N)	$2,120	$0		
	2 Executive Chairs (N)	$796	$0		
	1 Secretarial Desk (N)	$1,495	$0		
	1 Secretarial Chair (N)	$302	$0		
	5 Side Chairs (N)	$1,325	$0		
	3 File Cabinets (N)	$876	$0		
	1 Typewriter (N)	$371	$0		
	2 Bookcases (N)	$658	$0		
	3 Computer Workstations (N)	$3,021	$0		
	1 Large Copier (N)	$6,842	$0		
	1 Work Table (N)	$710	$0		
	1 Supply Cabinet (N)	$235	$0		
	1 Fireproof File Cabinet (Safe) (N)	$1,908	$0		
534528	Equipment - Communications		N/R	$2,268	$0
	3 Telephone Units & Installation (N)	$1,500	$0		
	1 FAX Machine & Installation (N)	$768	$0		
534534	PC/Printer Equipment		N/R	$15,550	$0
	3 Wireless Laptop or Desktop Computer Systems (R)	$10,500	$0		
	3 Docking Stations (N)	$1,200	$0		
	1 Scanner (N)	$1,250	$0		
	1 Laser Printer (Color) (N)	$2,600	$0		

(Continued on Next Page)

BUDGET CODE: 12000 DEPARTMENT: THE N.C. JUDICIAL BRANCH
FUNDS: 1300-1230, 1100, & 1500 MAIN TITLE: TRIAL COURTS - SUPERIOR COURT

TITLE OF REQUEST: BUSINESS COURT IN EXISTING COURT FACILITY

LEGISLATIVE CHANGES/ADDITIONS REQUIRED TO IMPLEMENT? YES_X___NO_____

DETAIL DAS OBJECT				WHOLE DOLLARS 2007-08	2008-09
Objective:	This proposal is to add a new Business Court to be established in an existing Court Facility.				
1500 1860	Reserves - Equipment & Supplies (Continued)				
534532	Video Courtroom Installation		N/R	$70,000	$0
	1 AV (Video) Courtroom System Equipment Installation				
534535	Server Purchases		N/R	$11,500	$0
	1 Server (Windows 2003) (N)	$10,000	$0		
	1 Wireless Router with Additional Gain Antenna (N)	$1,500	$0		
534630	Library & Legal Resources (Set of NCGS & Upgrades)			$684	$717
534711	Other Computer Software		N/R	$1,637	$0
534713	Personal Computer Software		N/R	$3,000	$0
	3 Sets of Software (N)	$3,000	$0		
	TOTAL REQUIREMENTS			$286,441	$136,558
	RECEIPTS			$0	$0
	APPROPRIATION			$286,441	$136,558
	NUMBER OF POSITIONS			2.00	2.00

BUSINESS COURT IN EXISTING COURT FACILITY	2007-08	2008-09
RECURRING COSTS	$135,827	$136,558
NONRECURRING COSTS	$150,614	$0
TOTAL REQUIREMENTS	$286,441	$136,558

BUDGET CODE: 12000 DEPARTMENT: THE N.C. JUDICIAL BRANCH
FUNDS: 1300-1230, 1100, & 1500 MAIN TITLE: TRIAL COURTS - SUPERIOR COURT

TITLE OF REQUEST: BUSINESS COURT IN A NEW COURT FACILITY

LEGISLATIVE CHANGES/ADDITIONS REQUIRED TO IMPLEMENT? YES_X___NO_____

DETAIL DAS OBJECT				WHOLE DOLLARS 2007-08	WHOLE DOLLARS 2008-09
Objective:	This proposal is to add a new Business Court to be established in to be created new court facility.				
1300 1230	Trial Courts - Superior Court	07-08	08-09		
531111	EPA-Reg. Salaries - Approp. - Effective 7/01/07			$81,799	$81,799
	1 (FR) Business Court Legal Assistant (RA's)	$43,635	$43,635		
	1 (FR) Business Court Judicial Assistant II	$38,164	$38,164		
531511	Social Security Contributions			$6,259	$6,259
531521	Retirement Contributions			$5,841	$5,841
531561	Hospital Insurance Contributions			$7,708	$7,708
532310	Repairs - Buildings - Create Court Site (Renovation of Space for Courtroom & Wiring Upgrades @ $25 per Sq. Ft. X 4,000 sq. ft.)		N/R	$100,000	$0
532512	Rent/Lease - Buildings & Offices (& Utilities)- New Court Site Estimate			$72,000	$72,000
532714	Transportation-Ground In-State (Training)			$485	$485
532721	Lodging - In-State (Training)			$299	$299
532724	Meals - In-State (Training)			$160	$160
532821	Computer/Data Processing Services (CLR)			$720	$720
532821	Computer/Data Processing Services (Case Management Licensing)		N/R	$26,000	$0
532840003	Postage/Postage Meter			$426	$460
1100	Administration & Services				
532430	Maintenance Agreements - Equipment (Copier)			$1,878	$1,972
532430	Maintenance Agreements - Equipment (Telecommunications)			$100	$104
532447	Maintenance Agreements - PC's & Printers			$186	$230
532448	Maintenance Agreements for PC Software			$0	$0
532449	Maintenance Agreements for Server Software (Help Desk)			$20,000	$20,000
532811	Telephone Service			$2,010	$2,093
532812	Telecom. Data Charges - T1 Data Line (New Site) + Network Connections			$11,134	$11,300
532930	Registration & Training Fees			$1,060	$1,060
535890	Other Administrative Expense			$1,000	$1,000
1500 2008	Equipment & Other Reserves - Equipment & Supply Purchases - 2007-08				
1500 2009	Equipment & Other Reserves - Equipment & Supply Purchases - 2007-09			RCC 2008	RCC 2009
533110	Office Supplies & Materials (Includes Copier, FAX, Laser Printer)			$4,078	$4,351
534521	Office Equipment		N/R	$35,659	$0
	Courtroom Furnishings - New Court Site	$15,000	$0		
	2 Executive Desks (N)	$2,120	$0		
	2 Executive Chairs (N)	$796	$0		
	1 Secretarial Desk (N)	$1,495	$0		
	1 Secretarial Chair (N)	$302	$0		
	5 Side Chairs (N)	$1,325	$0		
	3 File Cabinets (N)	$876	$0		
	1 Typewriter (N)	$371	$0		
	2 Bookcases (N)	$658	$0		
	3 Computer Workstations (N)	$3,021	$0		
	1 Large Copier (N)	$6,842	$0		
	1 Work Table (N)	$710	$0		
	1 Supply Cabinet (N)	$235	$0		
	1 Fireproof File Cabinet (Safe) (N)	$1,908	$0		
534528	Equipment - Communications		N/R	$17,268	$0
	LAN & Telephone Line Installations - New Site	15,000	$0		
	3 Telephone Units & Installation (N)	$1,500	$0		
	1 FAX Machine & Installation (N)	$768	$0		

(Continued on Next Page)

BUDGET CODE: 12000 DEPARTMENT: THE N.C. JUDICIAL BRANCH
FUNDS: 1300-1230, 1100, & 1500 MAIN TITLE: TRIAL COURTS - SUPERIOR COURT

TITLE OF REQUEST: BUSINESS COURT IN A NEW COURT FACILITY

LEGISLATIVE CHANGES/ADDITIONS REQUIRED TO IMPLEMENT? YES_X___NO_____

DETAIL DAS OBJECT				WHOLE DOLLARS 2007-08	WHOLE DOLLARS 2008-09
Objective:	This proposal is to add a new Business Court to be established in to be created new court facility.				
1500 1860	Reserves - Equipment & Supplies (Continued)				
534534	PC/Printer Equipment		N/R	$15,550	$0
	3 Wireless Laptop or Desktop Computer Systems (R)	$10,500	$0		
	3 Docking Stations (N)	$1,200	$0		
	1 Scanner (N)	$1,250	$0		
	1 Laser Printer (Color) (N)	$2,600	$0		
534532	Video Courtroom Installation		N/R	$70,000	$0
	1 AV (Video) Courtroom System Equipment Installation				
534535	Server Purchases		N/R	$11,500	$0
	1 Server (Windows) (N)	$10,000	$0		
	1 Wireless Router with Additional Gain Antenna (N)	$1,500	$0		
534630	Library & Legal Resources (Set of NCGS & Upgrades)			$684	$717
534711	Other Computer Software		N/R	$1,637	$0
534713	Personal Computer Software		N/R	$3,000	$0
	3 Sets of Software (N)	$3,000	$0		
	TOTAL REQUIREMENTS			$498,441	$218,558
	RECEIPTS			$0	$0
	APPROPRIATION			$498,441	$218,558
	NUMBER OF POSITIONS			2.00	2.00

BUSINESS COURT IN A NEW COURT FACILITY	2007-08	2008-09
RECURRING COSTS	$217,827	$218,558
NONRECURRING COSTS	$280,614	$0
TOTAL REQUIREMENTS	$498,441	$218,558

U.S. Department of Justice
Office of Justice Programs

Bureau of Justice Statistics
Bulletin

April 2006, NCJ 212260

Justice Expenditure and Employment in the United States, 2003

Kristen A. Hughes
BJS Statistician

In 2003 the United States spent a record $185 billion for police protection, corrections, and judicial and legal activities. Expenditures for operating the Nation's justice system increased from almost $36 billion in 1982 to over $185 billion in 2003, an increase of 418%.

Local governments funded half of all justice system expenses. Another 33% of direct justice funding came from the States.

Total justice expenditures comprised approximately 7.2% of all State and local public expenditures in 2003. Compared to justice expenditures, State and local governments continued to spend almost 4 times as much on education, twice as much on public welfare, and roughly an equal amount on hospitals and healthcare (figure 3).

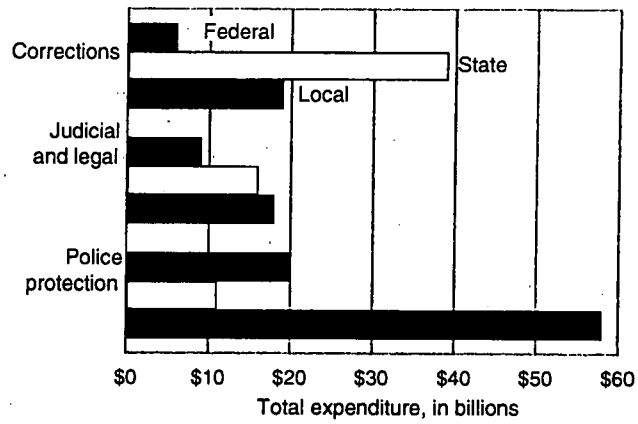
In March 2003 the Nation's justice system employed nearly 2.4 million persons, with a total March payroll of approximately $9 billion. More than half of all justice employees worked at the local level (58%), a third were State employees (31%), and the remaining 11% worked at the Federal level.

Data presented in this report are derived from the Justice Expenditure and Employment Extracts, compiled from the U.S. Census Bureau's Annual Government Finance Survey and Annual Survey of Public Employment.

Highlights

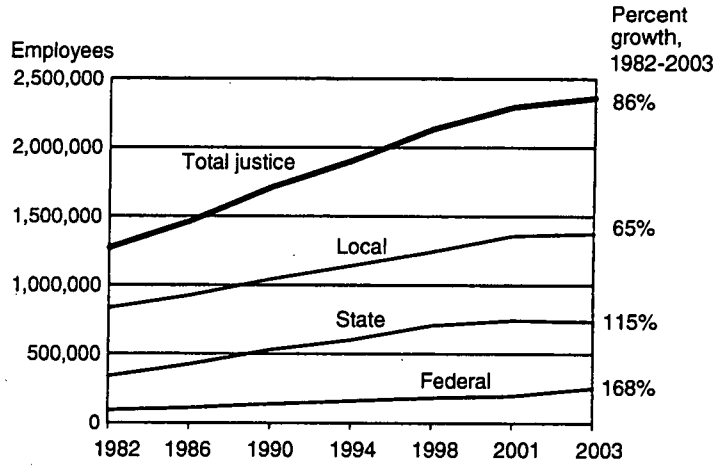
Expenditure for justice functions varies by level of government

In fiscal year 2003 States spent the most — $39.2 billion — for corrections. Local governments spent the most for police functions — $57.5 billion.



Justice employees by level of government

The total number of justice employees grew 86% between 1982 and 2003 with the Federal Government having the largest percentage increase —168%.



The extracts present public expenditure and employment data pertaining to justice activities in the United States, including police protection, judicial and legal services, and correctional activities. (For definition of terms, see page 9).

Trends in spending by level of government

Between 1982 and 2003, per capita expenditure, including Federal, State, and local governments across justice functions, increased from $158 to $638, over 300% (see *Appendix table*, page 9). During the same time period:

- Correction expenditures increased 423%, from $40 to $209 per U.S. resident (figure 1).
- Judicial and legal expenditures increased 321%, from $34 to $143.
- Police protection expenditures increased 241%, from $84 to $286.

Since 1982 total direct expenditures increased more than five-fold from nearly $36 billion to over $185 billion, a 418% increase (figure 2). The average annual increase between 1982 and 2003 was nearly 8% (table 1).

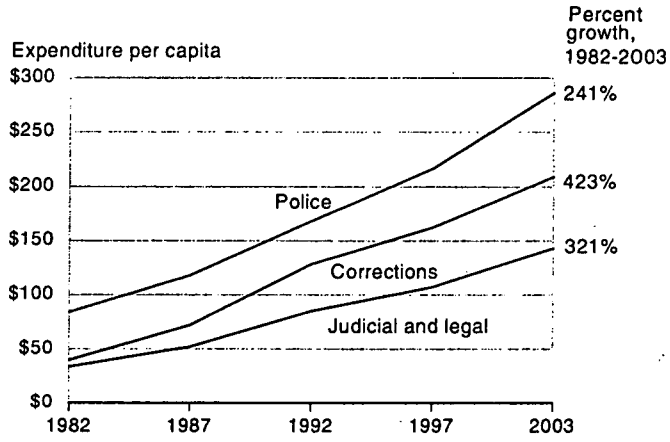
The total justice expenditure reflected the Federal Government's expanded role as it had a larger average annual increase in justice spending from 1982 to 2003 (10%) than State and local governments (8% and 7% respectively).

Federal intergovernmental spending on justice activities rose from $189 million in 1982 to more than $5.1 billion in 2003. This increase was due primarily to the creation of several large law enforcement related grant programs in the 1980's and 1990's.[1]

Between 1982 and 2003, the Federal Government increased expenditures on police protection by 708%, judicial and legal services by 573%, and corrections by 925%. State and local governments had smaller percent increases in all functions (table 2).

[1]For detailed information on Federal Government grants and payments to State and local governments see U.S. Census Bureau publication *Federal Aid to States for Fiscal Year 2003* at <http://www.census.gov/prod/abs/fas.html>.

Total per capita expenditure for each justice functions increased between 1982 and 2003, with corrections having the largest per capita increase — 423%



Note: See *Appendix table* on page 9 for more information.

Figure 1

Table 1. Total, direct, and intergovernmental justice expenditure and percent change, by level of government fiscal years 1982-2003

Year	Total* (Federal, State, and local direct)	Federal Total	Federal Direct	Federal Intergovernmental	State Total	State Direct	State Intergovernmental	Local Total	Local Direct	Local Intergovernmental
Expenditure (in millions)										
1982	$35,842	$4,458	$4,269	$189	$11,602	$10,651	$951	$20,968	$20,922	$46
1987	58,871	7,496	7,231	265	20,157	18,465	1,692	33,265	33,175	90
1992	93,777	17,423	13,529	3,894	33,755	30,271	3,484	50,115	49,977	138
1997	129,793	27,065	20,524	6,541	46,444	42,353	4,091	67,083	66,916	167
2000	155,722	27,820	23,086	4,734	58,165	53,991	4,175	78,995	78,644	351
2001	167,113	30,443	25,285	5,158	63,372	58,820	4,552	83,377	83,007	370
2002	179,580	34,346	28,548	5,798	65,508	60,912	4,596	90,485	90,120	366
2003	185,490	35,323	30,197	5,126	66,114	61,743	4,371	93,877	93,550	327
Percent change										
1982-2003	417.5%	692.4%	607.4%	2,612.2%	469.9%	479.7%	359.6%	347.7%	347.1%	610.9%
Average annual percent change, 1982-2003	7.7%	9.9%	9.3%	16.2%	8.2%	8.3%	7.2%	7.1%	7.0%	9.3%

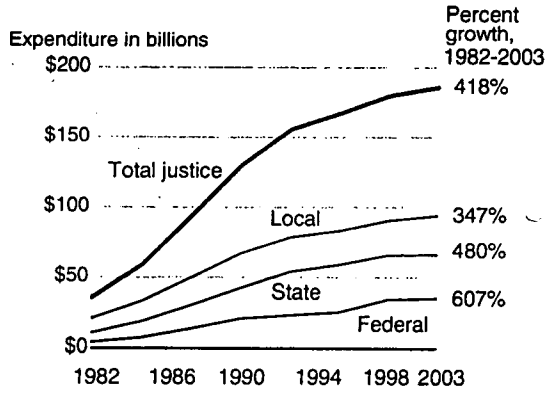
Note: Detail may not add to total because of rounding.
*Duplicative transactions between levels of government (intergovernmental transfers) are excluded from the total for all governments, the State total, and the local total. These intergovernmental expenditures consist of payments from one government to another and are presented as a direct expenditure of a recipient government. See page 9 for further details.

Trends by function

The average annual increase was highest for corrections, ranging from a 9% increase by the local governments to an 11% increase by the Federal Government.

Among State and local governments police protection experienced the lowest average annual increase; the average annual increase was about 6.5%. The Federal Government expenditure for police protection has increased 10% annually.

The total direct justice expenditure for all levels of government grew from $36 billion in 1982 to $185 billion in 2003, a 418% increase



Note: Does not include indirect expenditures.

Figure 2

Accounting for inflation

The Consumer Price Index (CPI), reported by the Bureau of Labor Statistics, is a commonly used measure of inflation.* According to the CPI, the average price level for all urban consumers increased 184% between the base years 1982-84 and 2003; the annual average increase was 2.3%.

To maintain consistency in reporting, the expenditure data discussed in this Bulletin are not adjusted for inflation. However, expenditure on all justice functions and among all levels of government increased at a rate greater than inflation. For example, if increases in total justice expenditure were limited to the rate of inflation (184%) after 1982, expenditures in 2003 would have been approximately $65.7 billion ($35.7B x 184%), as opposed to the actual $185.5 billion.

Justice expenditure relative to the Gross Domestic Product (GDP)

A common way to express the size and growth of government functions is the ratio of expenditure to the GDP or "percent GDP."** In 2003, the ratio of justice expenditure to GDP was $185 billion/$10,182 billion (1.8%). In 1982 the percent GDP was 1.1%.

*For more information about the Bureau of Labor Statistics website: <http://www.bls.gov>.
**For more information about the GDP, see the Bureau of Economic Analysis website: <http://www.bea.gov>.

Table 2. Total direct and intergovernmental expenditure of Federal, State, and local governments for each justice function, and percent change, fiscal years 1982-2003

	Federal				State				Local			
	Total	Police protection	Judicial and legal	Correc-tions	Total	Police protection	Judicial and legal	Correc-tions	Total	Police protection	Judicial and legal	Correc-tions
Expenditure (in millions)												
1982	$4,458	$2,527	$1,390	$541	$11,602	$2,833	$2,748	$6,020	$20,968	$14,172	$3,784	$3,011
1987	7,496	4,231	2,271	994	20,157	4,067	4,339	11,691	33,265	21,089	6,230	5,947
1992	17,423	7,400	7,377	2,646	33,755	5,593	7,723	20,439	50,115	29,659	10,052	10,404
1997	27,065	12,518	10,651	3,896	46,444	7,501	9,803	29,141	67,083	40,976	13,101	13,007
2000	27,820	13,999	9,353	4,467	58,165	9,787	13,249	35,129	78,995	48,219	14,842	15,934
2001	30,443	15,014	10,230	5,199	63,372	10,497	14,444	38,432	83,377	50,718	15,938	16,721
2002	34,346	17,626	11,013	5,707	65,508	11,081	15,365	39,062	90,485	55,086	17,042	18,358
2003	35,323	20,422	9,356	5,545	66,114	11,144	15,782	39,187	93,877	57,503	17,718	18,656
Percent change												
1982-2003	692.4%	708.2%	573.1%	925.0%	469.9%	293.4%	474.3%	550.9%	347.7%	305.8%	368.2%	519.6%
Average annual percent change, 1982-2003	9.9%	10.0%	9.1%	11.2%	8.2%	6.4%	8.3%	8.9%	7.1%	6.6%	7.3%	8.6%

Note: Detail may not add to total because of rounding.

Sources for Federal Expenditure Data: 1982-96 Annual Finance Survey, U.S. Census Bureau. For 1997-99, detailed functional tables, *Budget Authority by Function, Category and Program.* For 2000-03, historical tables, "Outlays by function and subfunction," Office of Management and Budget, Executive Office of the President.

Distribution of direct expenditure by level of government and activity

Within each category of justice activity, the distribution of expenditure by level of government reflects the different responsibilities of each level (table 3):

- Overall, police spending represented 45% of the Nation's total justice expenditure, and corrections accounted for the second largest portion, 33%.
- Police protection is primarily a local responsibility; accordingly, local governments spent 69% of the total police protection expenditure in the country in 2003.
- Corrections is primarily a State responsibility; as such State governments accounted for 61% of the Nation's corrections expenditure.
- Judicial and legal services in the United States were funded primarily by local (42%) and State (36%) governments.

The Federal Government spent the most on intergovernmental grants-in-aid, shared revenues, and amounts paid to other governments for services performed. Almost 92% of the Federal intergovernmental expenditure was for police protection, much of which was distributed through law enforcement related grants.

Table 3. Expenditure by level of government and justice activity, fiscal year 2003

	Amounts (millions of dollars) spent fiscal year 2003			
Activity	All governments	Federal government	State government	Local government
Total justice system	--	$35,323	$66,114	$93,877
Direct Expenditure	$185,490	30,197	61,743	93,550
Intergovernmental	--	5,126	4,371	327
Police protection	--	$20,422	$11,144	$57,503
Direct Expenditure	$83,089	15,728	9,860	57,501
Intergovernmental	--	4,694	1,284	2
Judicial and legal	--	$9,356	$15,782	$17,718
Direct Expenditure	$41,545	9,085	14,945	17,516
Intergovernmental	--	271	837	203
Corrections	--	$5,545	$39,188	$18,656
Direct Expenditure	$60,855	5,384	36,938	18,533
Intergovernmental	--	161	2,250	123

Note: Detail may not add to total because of rounding. Local government data are estimates subject to sampling variability. The total figure for each justice activity, and for the total justice system, exclude duplicative intergovernmental amounts. Artificial inflation would result if an intergovernmental expenditure of a government were tabulated and then counted again when the recipient government(s) spent the amount. The intergovernmental expenditure lines are not totaled for the same reason.
--Not applicable

Justice share of State and local expenditures

In 2003, 7.2% of total State and local expenditures was for justice activities – 3% for police protection, 2.6% for corrections, and 1.5% for judicial and legal services (figure 3).

By comparison, 29% of State and local government spending went to education, 14% to public welfare, 7% to health care and hospitals, and 4% to interest on debt.

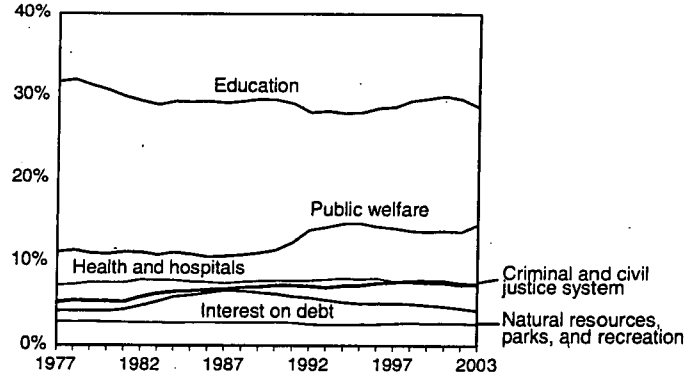
From 1977 to 2003 total State and local expenditure for all functions increased 567%:

- police protection — 545%
- corrections — 1,173%
- judicial and legal — 1,974%

Other government functions also increased during the same period:

- education — 505%
- hospitals and health care — 572%
- interest on debt — 577%
- public welfare — 766%

Percent of State and local direct expenditures for selected functions, 1977-2003



Note: The government functions included will not sum to 100% of government spending, because some functions were excluded for display purposes. Figures may not match those from the Expenditure and Employment Extracts because of definitional difference.

Source: Historical Finances, U.S. Census Bureau

Figure 3

Expenditure of State governments

In 2003 total justice system expenditure of State governments increased from $34 billion in 1993 to over $66 billion in 2003 — a 93% increase.

Total per capita justice expenditure of all State governments was $227 (table 4). Alaska spent the most on justice functions at $621 per U.S. resident, followed by Delaware ($478) and Connecticut ($372). Mississippi and Nevada spent the least per capita for all justice functions at $150 and $147, respectively.

Table 4. Per capita justice system expenditure of State governments, 2003

State	Population (2003)	Total	Per capita
Alaska	648,510	$402,981,000	$621
Delaware	817,827	391,138,000	478
Connecticut	3,485,881	1,295,675,000	372
Massachusetts	6,417,565	2,195,841,000	342
Wyoming	501,915	166,963,000	333
Maryland	5,512,477	1,779,373,000	323
Vermont	619,092	185,909,000	300
New Mexico	1,879,252	550,994,000	293
Virginia	7,383,387	2,151,666,000	291
Rhode Island	1,075,729	304,930,000	283
California	35,456,602	9,999,263,000	282
Hawaii	1,248,200	340,525,000	273
New Jersey	8,640,028	2,331,274,000	270
New York	19,228,031	5,119,031,000	266
Oregon	3,562,681	905,606,000	254
Kentucky	4,116,780	995,024,000	242
Pennsylvania	12,364,930	2,952,157,000	239
Wisconsin	5,471,792	1,288,541,000	235
Louisiana	4,490,380	1,034,713,000	230
Colorado	4,548,071	1,040,540,000	229
All States	290,292,159	66,114,297,000	228
Michigan	10,078,146	2,263,094,000	225
Oklahoma	3,504,917	766,469,000	219
Montana	917,885	198,787,000	217
Kansas	2,724,224	582,578,000	214
Iowa	2,941,362	624,765,000	212
North Carolina	8,422,375	1,740,172,000	207
Utah	2,378,696	489,339,000	206
Ohio	11,431,748	2,279,090,000	199
Florida	16,993,369	3,349,401,000	197
Georgia	8,746,849	1,716,621,000	196
Maine	1,308,245	254,318,000	194
Arizona	5,577,784	1,073,579,000	192
Texas	22,099,136	4,232,878,000	192
Idaho	1,368,111	261,872,000	191
West Virginia	1,810,347	339,981,000	188
Arkansas	2,726,166	505,996,000	186
New Hampshire	1,287,594	235,600,000	183
Washington	6,131,131	1,121,650,000	183
Missouri	5,718,717	1,033,070,000	181
Minnesota	5,061,662	904,850,000	179
South Carolina	4,146,753	740,178,000	178
Nebraska	1,738,013	301,564,000	174
South Dakota	764,599	132,376,000	173
Illinois	12,649,940	2,089,490,000	165
Alabama	4,501,862	712,838,000	158
Tennessee	5,841,585	914,068,000	156
Indiana	6,196,269	959,292,000	155
North Dakota	633,051	97,689,000	154
Mississippi	2,880,793	432,090,000	150
Nevada	2,241,700	328,458,000	147

Note: Population figures are from the U.S. Census Bureau, Annual Population Estimates 2000-2005.

Source: Criminal Justice Expenditure and Employment Extracts Program (CJEE), table 9. <www.ojp.usdoj.gov/bjs/eande.htm>

Distribution of employment by level of government and activity

In March 2003 the Nation's civil and criminal justice system employed over 2.3 million persons, with a total March payroll of $9 billion (table 5). Relative to the entire employed population in 2003, approximately 2% of the Nation's labor force worked in the justice system. (For more detailed information on the national labor force, see <http://www.bls.gov/cps/cpsaat1.pdf>.)

Local governments accounted for more justice employment than the Federal and State governments combined. Of all the Nation's justice employees, 58% were engaged in local justice activities.

The State and local governments employed almost 89% of all justice system workers, while the Federal Government employed the remaining 11%.

The distribution of corrections employment reflects State government dominance in that sector — 62% of corrections employees worked for State governments, followed by 33% at the local level and 5% at the Federal level (figure 4).

As law enforcement is primarily the responsibility of local governments, 77% of the Nation's police employees worked at the local level. The Federal Government employed 14% of police protection personnel while State governments employed the remaining 10%.

Throughout the justice system, an estimated 59% of total justice expenditures were for payroll.[2]

[2]This figure was calculated by multiplying the March 2003 payroll figure by 12 and dividing by total justice expenditure.

In 2003, the Federal Government spent less on payrolls relative to total expenditure ($15 billion out of 35 billion or 43%) than did State and local governments (48% and 65% respectively).

Police protection was the activity with the highest percentage of expenditure going to payrolls (66%). In particular 70% of local government justice expenditure went to police protection.

The activity with the lowest percentage of payroll expenditure for all levels of government was corrections at approximately 50%.

Local governments employed over 850,000 persons for police protection in March 2003 and over half of all judicial and legal employees across all levels of government

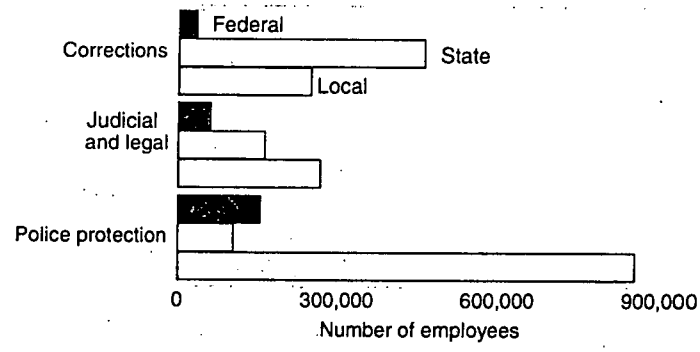


Figure 4

Table 5. Employment and monthly payroll of the justice system, by activity and level of government, March 2003

Activity	All governments	Federal	State	Local	Percent distribution: Total	Federal	State	Local
Total justice system								
Total employees	2,361,193	253,367	733,570	1,374,256	100%	10.7%	31.1%	58.2%
2003 March payroll*	$9,041	$1,279	$2,639	$5,123	100	14.1	29.2	56.1
Police protection								
Total employees	1,118,936	156,607	105,933	856,396	100%	14.0%	9.5%	76.5%
2003 March payroll*	$4,545	$760	$438	$3,347	100	16.7	9.6	73.6
Judicial and legal								
Total employees	494,007	61,984	164,051	267,972	100%	12.5%	33.2%	54.2%
2003 March payroll*	$1,969	$353	$682	$934	100	17.9	34.6	47.4
Corrections								
Total employees	748,250	34,776	463,586	249,888	100%	4.6%	62.0%	33.4%
2003 March payroll*	$2,526	$165	$1,519	$842	100	6.5	60.1	33.3

Note: Detail may not add to total because of rounding. These data are based on a summation of responses from individual State and local government agencies. Local government data are estimates subject to sampling variability, see Methodology for details. Refer to Bureau of Justice Statistics Report, *Federal Law Enforcement Officers, 2002* for detail of Federal employment <http://www.ojp.usdoj.gov/bjs/abstract/fleo02.htm>.
*Payroll is in millions.

Employment by State

In total, almost 13% of State and local employees worked in the justice system (table 6). Nevada had the highest percentage of justice employees relative to all public employees (16.9%), followed by Florida (16.6%).

The States with the lowest percentage of justice employees were Vermont and North Dakota (both at less than 8%).

Expansion of the Nation's justice system 1982-2003

The increase in justice expenditures over nearly 20 years reflects the expansion of the Nation's justice system. For example, in 1982 the justice system employed approximately 1.27 million persons; in 2003 it reached over 2.3 million.

Police protection

One indicator of police workload, the FBI's arrest estimates for State and local police agencies, grew from 12 million in 1982 to an estimated 13.6 million in 2003.* The number of employees in police protection increased from approximately 724,000 to over 1.1 million.

Judicial and legal

The judicial and legal workload, including civil and criminal cases, prosecutor functions, and public defender services, also expanded during this period. Cases of all kinds (criminal, civil, domestic, juvenile, and traffic) filed in the nearly 16,000 general and limited jurisdiction State courts went from about 86 million to 100 million in the 16-year period, 1987-2003.** The total of judicial and legal employees grew about 101% to over 494,000 persons in 2003.

Corrections

The total number of State and Federal inmates grew from 403,000 in 1982 to over 1.4 million in 2003. The number of local jail inmates more than tripled from approximately 207,000 in 1982 to over 691,000 in 2003. Adults on probation increased from over 1.4 million to about 4.1 million persons.*** Overall, corrections employment more than doubled from nearly 300,000 to over 748,000 during this same period.

*Crime in the United States, 1982 (FBI, 1983) and 2003 (FBI, 2004), <http://www.fbi.gov/ucr/cius_03/pdf/toc03.pdf>.
**Examining the Work of State Courts, 2003: A National Perspective from the Court Statistics Project, National Center for State Courts, <http://www.ncsconline.org/D_Research/csp/2003_Files/2003_Main_Page.html>.
***Sourcebook of Criminal Justice Statistics, 2003 (table 6.1.2004), <http://www.albany.edu/sourcebook/pdf/t612004.pdf>.

Table 6. State and local justice system employment and percent of all public employment, by State, March 2003

State	Full-time equivalent employment: All State and local public	State and local justice	Justice as a percent of total
Nevada	92,655	15,687	16.9%
Florida	806,682	133,772	16.6
Arizona	261,492	40,583	15.5
District of Columbia	44,271	6,870	15.5
Delaware	45,947	73,934	15.1
New Jersey	489,448	6,926	15.1
New York	1,193,262	176,622	14.8
Maryland	287,513	39,577	13.8
Pennsylvania	569,356	78,232	13.7
Louisiana	279,087	37,861	13.6
Illinois	641,248	86,279	13.5
Missouri	311,972	41,803	13.4
Georgia	484,515	64,637	13.3
California	1,805,446	238,806	13.2
Massachusetts	320,372	42,151	13.2
Connecticut	176,369	22,626	12.8
All State and local	15,760,451	2,002,706	12.7%
Ohio	619,869	78,124	12.6%
Hawaii	71,764	8,879	12.4
Texas	1,253,022	155,979	12.4
Michigan	512,026	62,597	12.2
Wisconsin	288,044	35,225	12.2
Tennessee	311,601	37,024	11.9
New Mexico	122,040	14,348	11.8
South Carolina	242,222	28,496	11.8
Virginia	411,100	47,922	11.7
Oregon	181,607	21,049	11.6
Rhode Island	55,944	6,469	11.6
Colorado	256,018	29,205	11.4
Indiana	332,380	38,048	11.4
North Carolina	469,942	53,684	11.4
Arkansas	153,382	17,345	11.3
Washington	321,153	35,619	11.1
Utah	122,209	13,146	10.8
Oklahoma	201,632	21,597	10.7
Idaho	78,548	8,194	10.4
Alaska	51,102	5,191	10.2
Kansas	178,042	18,221	10.2
Wyoming	43,651	4,467	10.2
Montana	52,886	5,337	10.1
New Hampshire	68,192	6,893	10.1
Kentucky	227,902	22,879	10.0
West Virginia	93,383	9,341	10.0
Alabama	269,674	26,036	9.7
Mississippi	186,130	17,592	9.5
Minnesota	283,691	26,155	9.2
Nebraska	113,703	10,372	9.1
South Dakota	43,445	3,865	8.9
Iowa	179,633	14,868	8.3
Maine	75,041	6,205	8.3
North Dakota	41,178	3,110	7.6
Vermont	38,660	2,858	7.4

Note: These data are based on a summation of responses from individual State and local government agencies. Local government data are estimates subject to sampling variability. See *Methodology* for details.

Source: Annual Survey of Government Employment, U.S. Census Bureau, March (2003).

California had the most State and local employees (1.8 million) as well as the largest number of employees in the justice system (247,110).[3] Vermont was the State with the fewest justice employees in State and local government (slightly over 3,000) and for all functions (approximately 39,000).

In March 2003 the number of full-time equivalent (FTE) State and local government justice system employees was just over 2 million (table 7). Almost 45% of all FTE justice system State and local employees worked in police protection; 35% were employed in corrections, while the remaining 20% were in judicial and legal jobs.

The District of Columbia had the largest percentage of FTE State and local justice system employees working in police protection at 63%. Massachusetts and Rhode Island followed at 56% and 54%, respectively. At 37%, Delaware had the smallest percentage of employees working in police protection.

In corrections, Texas had the largest percentage of FTE State and local justice system employees at 46%. Virginia and North Carolina followed at 44% and 43%, respectively.

[3]Source for these data is the Criminal Justice Expenditure and Employment Extracts Program (CJEE), table 5. <www.ojp.usdoj.gov/bjs/eande.htm>.

Table 7. Justice system employment and percent distribution of full-time equivalent employment, by State and local government and activities, March 2003.

	Full-time equivalent employees*			
		Percent distribution		
State	Total justice system	Police protection	Judicial and legal	Corrections
Total	2,002,706	44.7%	20.4%	35.0%
California	238,806	42.6	22.8	34.6
New York	176,622	49.0	17.3	33.7
Texas	155,979	38.8	15.7	45.5
Florida	133,772	44.7	24.0	31.3
Illinois	86,279	53.2	19.8	27.0
Pennsylvania	78,232	40.6	22.5	36.8
Ohio	78,124	42.3	25.6	32.1
New Jersey	73,934	48.0	29.2	22.8
Georgia	64,637	39.4	18.4	42.2
Michigan	62,597	41.6	19.5	38.9
North Carolina	53,684	44.2	12.4	43.4
Virginia	47,922	41.0	15.4	43.6
Massachusetts	42,151	55.6	21.9	22.6
Missouri	41,803	45.2	19.5	35.3
Arizona	40,583	43.1	22.5	34.4
Maryland	39,577	43.2	18.6	38.2
Indiana	38,048	45.2	19.2	35.6
Louisiana	37,861	43.5	20.0	36.4
Tennessee	37,024	48.7	16.4	34.9
Washington	35,619	40.2	21.6	38.2
Wisconsin	35,225	46.3	17.0	36.7
Colorado	29,205	45.5	20.1	34.4
South Carolina	28,496	48.9	13.9	37.3
Minnesota	26,155	43.8	24.0	32.2
Alabama	26,036	51.0	19.5	29.5
Kentucky	22,879	42.6	27.2	30.2
Connecticut	22,626	45.8	20.9	33.2
Oklahoma	21,597	49.0	19.2	31.7
Oregon	21,049	39.3	21.3	39.4
Kansas	18,221	47.3	19.6	33.0
Mississippi	17,592	51.0	15.0	34.0
Arkansas	17,345	45.9	18.8	35.3
Nevada	15,687	44.4	20.7	34.9
Iowa	14,868	48.7	21.3	30.0
New Mexico	14,348	39.2	21.0	39.7
Utah	13,146	42.6	20.6	36.8
Nebraska	10,372	46.1	17.5	36.4
West Virginia	9,341	40.3	24.3	35.4
Hawaii	8,879	41.0	31.9	27.1
Idaho	8,194	45.0	19.9	35.1
Delaware	6,926	36.9	22.8	40.3
New Hampshire	6,893	53.2	18.1	28.7
District of Columbia	6,870	63.0	21.7	15.3
Rhode Island	6,469	53.6	19.4	27.1
Maine	6,205	50.0	16.4	33.6
Montana	5,337	43.4	24.5	32.1
Alaska	5,191	39.4	25.3	35.3
Wyoming	4,467	48.3	19.3	32.4
South Dakota	3,865	45.5	20.9	33.6
North Dakota	3,110	45.6	24.8	29.6
Vermont	2,858	43.2	22.3	34.4

Notes: Local government data are estimates subject to variability.
*Justice system employment of independent school districts and special school districts (primarily for special police) are not available.

Appendix table. Direct and per capita justice expenditure across government and by function, selected years, 1982-2003

Year	Population	Justice expenditure across government and function		Police protection expenditure		Judicial and legal expenditure		Corrections expenditure	
		Total (in millions)	Per capita	Total (in millions)	Per capita	Total (in millions)	Per capita	Total (in millions)	Per capita
2003	290,850,000	$185,490	$638	$83,089	$286	$41,545	$143	$60,855	$209
2002	287,985,000	179,580	624	79,540	276	40,431	140	59,609	207
1997	267,784,000	129,793	485	57,754	216	28,529	107	43,511	162
1992	245,807,000	93,777	382	41,327	168	20,989	85	31,461	128
1987	243,400,000	58,871	242	28,778	118	12,555	52	17,549	72
1982	226,548,000	35,842	158	19,022	84	7,771	34	9,049	40

Note: Using the Consumer Price Index (CPI) to adjust the 2003 per capita figure of $638 for inflation would yield approximately $335 in 1982 dollars. For more information on the CPI see the Bureau of Labor Statistics website <www.bls.gov>. Population figures are from the U.S. Census Bureau, Annual Population Estimates 2000-2005.

Definition of terms

Expenditure includes only external cash payments made from any source of funds, including any payments financed from borrowing, fund balances, intergovernmental revenue, and other current revenue. It excludes any intragovernmental transfers and noncash transactions, such as the provision of meals or housing of employees. It also excludes retirement of debt, investment in securities, extensions of loans, or agency transactions. Total expenditures for all government functions do include interest payments on debt, but the justice expenditure data do not.

Expenditures two major categories —

• *Direct expenditure* is all expenditure except that classified as intergovernmental. It includes "direct current expenditure" (salaries, wages, fees, and commissions and purchases of supplies, materials, and contractual services) and "capital outlays" (construction and purchase of equipment, land, and existing structures). Capital outlays are included for the year when the direct expenditure is made, regardless of how the funds are raised (for example, by bond issue) or when they are paid back.

• *Intergovernmental expenditure* is the sum of payments from one government to another, including grants-in-aid, shared revenues, payments in lieu of taxes, and amounts for services performed by one government for another on a reimbursable or cost-sharing basis (for example, payments by one government to another for boarding prisoners). It excludes amounts paid to other governments for purchase of commodities, property, or utility services.

Employees are all persons on government payrolls during the pay period including March 15, 2003. They include all paid officials and persons on paid leave, but exclude unpaid officials, persons on unpaid leave, pensioners, and contractors.

Full-time employees are all persons employed on a full-time basis, including all full-time temporary or seasonal workers who were employed during this pay period.

Full-time equivalent employment (FTE) is a statistical measure that estimates the number of full-time employees that could have been employed if the reported number of hours worked by part-time employees had been worked by full-time employees. This statistic is calculated separately for each function of a government by dividing the "part-time hours paid" by the standard number of hours for full-time employees in the particular government and then adding the resulting quotient to the number of full-time employees.

Payroll is the gross 1-month payroll before deductions and includes salaries, wages, fees, and commissions paid to employees as defined above for March 2003.

Components of total expenditure

The expenditure data discussed in this Bulletin include direct expenditure and intergovernmental expenditure. Intergovernmental expenditure is the sum of payments from one government to another, including grants-in-aid, shared revenues, and amounts for services performed by one government for another on a reimbursable or cost-sharing basis.

The three levels of government in the United States (Federal, State, and local) have varying responsibilities for justice activities, and funds are often passed between governments to reflect these responsibilities. For example, Federal intergovernmental expenditures include grants to States, and State direct expenditures will include those grants.

To avoid double counting the sum of Federal, State, and local intergovernmental expenditures, the direct expenditure is used to calculate total expenditure for all governments. For 2003, the total direct expenditure for all governments was over $185 billion.

Police protection is the function of enforcing the law, preserving order, and apprehending those who violate the law, whether these activities are performed by a city police department, sheriff's department, State police, or Federal law enforcement agency such as the Federal Bureau of Investigation or the Drug Enforcement Administration. Private security police are outside the scope of the survey.

Judicial and legal services include all civil and criminal courts and activities associated with courts such as law libraries, grand juries, petit juries, medical and social service activities, court reporters, judicial councils, bailiffs, and probate functions. It also includes the civil and criminal justice activities of the attorneys general, district attorneys, State's attorneys, and their variously named equivalents and corporation counsels, solicitors, and legal departments with various names. It excludes legal units of noncriminal justice agencies, whose functions may be performed by a legal services department in other jurisdictions (such as a county counsel).

Corrections involves the community supervision, confinement, and rehabilitation of adults and juveniles convicted of offenses against the law and the confinement of persons suspected of a crime awaiting trial or adjudication. It includes the costs of operation and employment for jails, prisons, probation, parole, pardon, and correctional administration. Data for institutions with authority to hold prisoners beyond arraignment (usually 48 hours or more) are included in this sector. Data for lockups or "tanks" holding prisoners less than 48 hours are included in "police protection."

Methodology

The justice data in this report include the expenditures and employment of the Federal Government, the State governments, and a sample of county, municipal, and township governments. Unless otherwise noted, data for total governmental functions and non-justice governmental functions also include the expenditures of special districts and school districts, which generally do not have justice functions.

This report is based on a compilation of data from the U.S. Census Bureau's annual surveys of governmental finances and employment. The survey sample was selected from the 1997 Census of Local Governments and consists of large units of government (including all 50 States) sampled with certainty and smaller units selected with a probability proportional to the unit's expenditure. The total number of local governments in the finance sample was 7,002, and the number of local governments in the employment sample was 10,574.

Certain limitations reflect the fact that the surveys from which this Bulletin was extracted are not designed to obtain data on specific justice functions. The sampling variability, or standard error, for each of the justice activities is likely to be larger than for the major categories that the surveys were designed to estimate. Similarly, the standard error is likely to be greater for local governments than for State-local aggregates which are sampled in part with certainty. Specific standard errors can be found on the Census Bureau's website (<http://www. census.gov>).

Differences in functional responsibilities from State to State and government to government can affect the comparability of expenditure and employment data. Readers should be generally cautious in comparing governmental expenditures because of this variation in the division of responsibilities.

The data in this report differ in some cases from those previously published in the Census Bureau's finance and employment survey reports because of definitional differences and the more intensive review procedures and data refinements used for this compilation.

Data on State and local justice system per capita expenditure by State and activity were not collected in 2003. These data are available for 2002.

The data here differ from other BJS series which collect agency-based employment and expenditure data because of collection methods, units of analysis, and data collection purposes. These include —

Law Enforcement Management and Administrative Statistics, Prosecutors in State Courts and various court statistics series, *The Census of Local Jails*, 1999, *The Census of State and Federal Correctional Facilities*, 2000, *and the report State Prison Expenditures*, 2001.

Financial data for the Federal Government were extracted from *The Budget of the United States Government, FY 2003, Appendix*. The historical finance data may differ slightly from the justice expenditure data found in the Expenditure and Employment Extracts because of definitional differences.

Federal Government civilian employment data were obtained from the U.S. Office of Personnel Management. Statistics for State and local governments were obtained by a mail survey including all State departments, agencies, and institutions, and a local central reporting office supplemented by special mailings.

Trend comparisons between the data in this report and reports covering data for 1971-79, 1985, 1988, 1990, and 1997 from the *Justice Assistance Data Survey* (JADS) are complicated by differences in methodology. These differences are described in the BJS reports for these years, and on the BJS website. In making trend comparisons, users should limit their analysis to one of the two sources:

- long-term trends for 1971-79, 1985, 1988,1990, and 1997 from the JADS
- recent year-to-year trends from the 1980-2001 Justice Expenditure and Employment Extracts data.

A more detailed description of the survey methodology (including sample design and sampling errors) can be found in the *Justice Expenditure and Employment Extracts* at <http://www.ojp.usdoj.gov/bjs>.

This report is available in portable document format and in ASCII. Its related statistical data and tables are available at the BJS World Wide Web Internet site: <http://www.ojp.usdoj.gov/bjs/>

The data from the Justice Expenditure and Employment Extracts are available from the National Archive of Criminal Justice Data, maintained by the Inter-university Consortium for Political and Social Research at the University of Michigan, 1-800-999-0960. The archive may also be accessed through the BJS Internet site.

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The Bureau of Justice Statistics is the statistical agency of the U.S. Department of Justice. Jeffrey L. Sedgwick is director.

BJS Bulletins present the first release of findings from permanent data collection programs.

Kristen Hughes wrote this report under the supervision of Steven K. Smith. Mark Motivans and Steven D. Owens provided statistical review. Tina Dorsey and Marianne W. Zawitz produced and edited the report. Jayne Robinson prepared the report for final printing.

The data extraction, editing, and tabulation for the 2002 and 2003 Justice Expenditure and Employment Extracts were performed at the U.S. Census Bureau by Steven D. Owens.

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FINES AND FORFEITURES
FISCAL YEAR 2005-2006

COUNTY	FINES	FORFEITURES	TOTAL
Alamance	$664,133.51	$1,042,831.02	1,706,964.53
Alexander	$90,019.95	$3,207.76	93,227.71
Alleghany	$49,656.23	$12,450.00	62,106.23
Anson	$275,217.50	$23,118.29	298,335.79
Ashe	$79,010.00	$17,483.00	96,493.00
Avery	$90,713.98	$42,485.34	133,199.32
Beaufort	$355,771.27	$82,275.17	438,046.44
Bertie	$172,537.03	$20,619.21	193,156.24
Bladen	$128,653.09	$40,566.58	169,219.67
Brunswick	$251,604.60	$128,300.10	379,904.70
Buncombe	$1,160,214.56	$330,500.65	1,490,715.21
Burke	$576,654.09	$56,885.62	633,539.71
Cabarrus	$1,452,035.84	$344,057.90	1,796,093.74
Caldwell	$348,585.82	$54,905.32	403,491.14
Camden	$94,419.00	$7,029.00	101,448.00
Carteret	$435,419.04	$121,174.50	556,593.54
Caswell	$117,833.00	$4,181.42	122,014.42
Catawba	$950,758.18	$184,777.95	1,135,536.13
Chatham	$233,612.00	$27,370.69	260,982.69
Cherokee	$206,988.35	$29,996.99	236,985.34
Chowan	$94,143.00	$13,589.75	107,732.75
Clay	$49,632.00	$7,160.00	56,792.00
Cleveland	$439,058.66	$50,977.72	490,036.38
Columbus	$151,400.70	$52,986.24	204,386.94
C[illegible]	$396,941.50	$89,294.89	486,236.39
[illegible]rland	$504,473.04	$237,466.65	741,939.69
Currituck	$309,130.50	$62,393.32	371,523.82
Dare	$708,770.84	$144,129.78	852,900.62
Davidson	$491,984.64	$142,073.76	634,058.40
Davie	$180,054.11	$16,642.14	196,696.25
Duplin	$402,067.29	$107,496.07	509,563.36
Durham	$1,028,539.06	$522,127.66	1,550,666.72
Edgecombe	$342,016.62	$168,034.41	510,051.03
Forsyth	$1,860,867.81	$822,471.34	2,683,339.15
Franklin	$284,589.67	$51,663.78	336,253.45
Gaston	$603,278.94	$230,821.07	834,100.01
Gates	$85,562.21	$11,657.56	97,219.77
Graham	$33,355.00	$9,000.00	42,355.00
Granville	$309,394.36	$65,906.82	375,301.18
Greene	$108,149.45	$600,005.64	708,155.09
Guilford	$1,855,133.24	$901,570.34	2,756,703.58
Halifax	$320,197.55	$124,292.10	444,489.65
Harnett	$427,797.37	$121,865.99	549,663.36
Haywood	$340,940.97	$146,251.53	487,192.50
Henderson	$423,051.86	$221,634.84	644,686.70
Hertford	$140,878.42	$73,740.65	214,619.07
Hoke	$183,997.64	$78,882.88	262,880.52
Hyde	$38,169.18	$10,587.04	48,756.22
Iredell	$659,800.18	$174,197.31	833,997.49
Jackson	$205,425.56	$44,913.76	250,339.32

COUNTY	FINES	FORFEITURES	TOTAL
Johnston	$453,920.57	$355,890.22	809,810.79
Jones	$77,770.00	$7,920.87	85,690.87
Lee	$348,279.17	$210,454.82	558,733.99
Lenior	$377,993.64	$129,226.68	507,220.32
Lincoln	$289,948.24	$147,835.44	437,783.68
Macon	$213,991.78	$26,770.85	240,762.63
Madison	$220,051.50	$3,450.00	223,501.50
Martin	$182,849.86	$2,743.73	185,593.59
McDowell	$294,872.12	$34,900.89	329,773.01
Mecklenburg	$2,111,581.14	$1,401,739.69	3,513,320.83
Mitchell	$72,200.39	$7,049.36	79,249.75
Montgomery	$243,182.79	$67,849.96	311,032.75
Moore	$549,200.04	$152,332.13	701,532.17
Nash	$362,693.91	$175,305.71	537,999.62
New Hanover	$973,689.28	$433,207.52	1,406,896.80
Northampton	$108,641.73	$34,013.99	142,655.72
Onslow	$652,927.56	$271,245.23	924,172.79
Orange	$576,172.87	$62,455.02	638,627.89
Pamilco	$41,692.65	$10,335.69	52,028.34
Pasquotank	$261,734.10	$92,459.60	354,193.70
Pender	$328,151.46	$94,122.99	422,274.45
Perquimans	$68,915.28	$26,396.86	95,312.14
Person	$198,006.46	$29,200.55	227,207.01
Pitt	$497,805.31	$214,083.57	711,888.88
Polk	$186,128.00	$21,925.00	208,053.00
Randolph	$877,098.57	$1,066,751.62	1,943,850.19
Richmond	$405,297.47	$59,389.54	464,687.01
Robeson	$728,930.74	$391,186.78	1,120,117.52
Rockingham	$462,815.62	$56,848.51	519,664.13
Rowan	$1,031,670.11	$410,533.75	1,442,203.86
Rutherford	$431,180.52	$47,538.69	478,719.21
Sampson	$432,112.50	$156,251.97	588,364.47
Scotland	$291,469.58	$70,333.49	361,803.07
Stanly	$513,809.64	$93,786.15	607,595.79
Stokes	$268,923.14	$20,861.54	289,784.68
Surry	$499,249.61	$80,324.55	579,574.16
Swain	$113,871.10	$11,700.00	125,571.10
Transylvania	$153,937.49	$27,932.33	181,869.82
Tyrrell	$120,891.00	$27,363.00	148,254.00
Union	$986,420.25	$202,233.82	1,188,654.07
Vance	$417,009.77	$108,861.23	525,871.00
Wake	$4,749,127.46	$1,188,775.13	5,937,902.59
Warren	$174,649.10	$20,245.11	194,894.21
Washington	$110,530.26	$11,695.95	122,226.21
Watauga	$348,118.26	$50,639.15	398,757.41
Wayne	$598,424.34	$230,996.00	829,420.34
Wilkes	$353,916.81	$141,836.28	495,753.09
Wilson	$359,750.98	$128,068.07	487,819.05
Yadkin	$221,221.14	$23,233.40	244,454.54
Yancey	$73,204.53	$5,501.44	78,705.97
TOTAL	45,128,668.25	16,523,855.42	61,652,523.67

Amounts of Fees, Fines, and Forfeitures Collected by the Courts and Distributed to Counties and Municipalities *

W O R K S H E E T

July 1, 2005 - June 30, 2006

County	Distributed to Counties				Distributed to Municipalities			
	Facility Fees	Officer Fees	Jail Fees	Fines and Forfeitures	Facility Fees	Officer Fees	Jail Fees	TOTAL
Alamance	302,255.08	120,320.43	85,790	1,706,965	0	45,114.14		2,260,445
Alexander	37,982.24	10,761.29	10,955	93,228	0	1,642.80		154,569
Alleghany	17,089.68	7,219.00	7,715	62,106	0	990.00		95,120
Anson	55,311.00	35,003.00	6,392	298,336	0	1,305.00		396,346
Ashe	33,118.11	19,261.52	6,462	96,493	0	2,127.50		157,462
Avery	26,923.22	10,601.41	3,461	133,199	0	1,906.63		176,092
Beaufort	151,568.51	53,580.17	24,232	438,046	0	18,638.88		686,066
Bertie	82,043.39	37,720.45	7,374	193,156	0	1,781.80		322,076
Bladen	91,722.60	44,508.29	13,042	169,220	0	3,781.43		322,274
Brunswick	167,994.67	107,286.29	33,390	379,905	48	898.00		689,521
Buncombe	375,002.07	167,051.28	76,893	1,490,715	0	38,719.00		2,148,380
Burke	187,232.86	45,586.00	30,327	633,540	0	18,180.34		914,866
Cabarrus	438,825.56	156,572.09	77,239	1,796,094	0	81,649.59		2,550,380
Caldwell	147,728.56	34,919.25	25,829	403,491	0	16,663.38		628,631
Camden	30,935.31	14,426.57	2,679	101,448	0	0.00		149,489
Carteret	210,154.85	69,287.00	34,473	556,594	0	20,910.68		891,419
Caswell	52,728.53	24,628.14	3,475	122,014	0	914.36		203,761
Catawba	205,748.72	53,285.00	24,223	1,135,536	123,793	53,724.06		1,596,310
Chatham	78,420.98	44,004.00	7,085	260,983	41,018	6,690.00		438,201
Cherokee	61,499.50	30,947.52	9,096	236,985	0	2,037.52		340,566
Chowan	29,769.54	12,769.45	8,548	107,733	0	4,219.00		163,039
Clay	15,826.90	9,099.44	11,962	56,792	0	0.00		93,681
Cleveland	198,805.04	106,227.45	35,983	490,036	0	14,637.01		845,689
Columbus	121,561.73	67,575.13	23,098	204,387	2,071	4,549.50		423,242
Craven	225,572.42	45,122.29	44,713	486,236	6,906	33,883.77		842,434
Cumberland	430,158.21	45,298.56	23,016	741,940	0	30,622.49		1,271,035
Currituck	96,900.80	54,700.01	11,824	371,524	0	0.00		534,949
Dare	211,983.38	46,493.01	18,615	852,901	0	31,740.86		1,161,733
Davidson	270,065.68	136,897.98	50,287	634,058	0	18,255.26		1,109,564
Davie	68,304.41	31,950.01	10,841	196,696	0	2,938.15		310,730
Duplin	175,297.16	54,611.33	21,896	509,563	0	7,399.38		768,767
Durham	559,858.12	330,879.64	4,942	1,550,667	0	80,558.51		2,526,905
Edgecombe	134,399.37	120,464.87	31,832	510,051	51,429	21,110.30		869,286
Forsyth	853,385.93	75,507.50	43,238	2,683,339	31,034	135,570.00		3,822,074
F[illegible]in	108,604.00	75,865.96	14,165	336,253	0	6,596.30		541,484
[illegible]	458,666.09	223,314.65	61,421	834,100	0	41,848.32		1,619,350
G[illegible]	30,949.31	17,164.59	6,741	97,220	0	0.00		152,075
Graham	13,473.50	4,632.03	3,669	42,355	0	0.00		64,129
Granville	111,937.61	28,493.00	15,729	375,301	0	7,707.00		539,167
Greene	42,843.64	20,237.05	8,086	708,155	0	0.00		779,322
Guilford	1,116,057.48	107,706.38	60,557	2,756,704	0	195,604.28		4,236,629
Halifax	147,920.52	76,963.19	16,024	444,490	0	10,481.20		695,879
Harnett	153,549.13	73,891.86	33,604	549,663	7,272	14,771.89		832,753
Haywood	133,995.92	50,318.85	145	487,193	6	9,118.54		680,777
Henderson	165,960.43	38,006.43	15,772	644,687	0	11,895.67		876,321
Hertford	58,845.63	25,793.86	12,851	214,619	0	6,520.85		318,630
Hoke	57,389.42	30,296.08	9,997	262,881	0	460.91		361,024
Hyde	14,048.74	6,943.91	719	48,756	0	0.00		70,467
Iredell	291,028.93	167,240.84	29,534	833,997	336	43,814.63	2	1,365,954
Jackson	69,105.01	32,865.82	8,035	250,339	0	5,483.64		365,829
Johnston	330,591.92	156,816.57	33,727	809,811	33,954	24,418.50		1,389,318
Jones	37,400.59	15,564.41	4,208	85,691	0	1,900.00		144,764
Lee	108,043.76	44,039.47	25,222	558,734	0	19,571.19		755,610
Lenior	177,865.84	45,106.35	43,747	507,220	0	15,257.00		789,197
Lincoln	104,660.24	47,015.01	39,763	437,784	0	5,013.26		634,235
Macon	70,459.17	35,257.30	6,083	240,763	0	1,116.32		353,679
Madison	48,659.05	21,618.12	7,248	223,502	0	940.10		301,966
Martin	79,830.05	38,693.18	4,889	185,594	0	754.79		309,761
McDowell	110,397.95	42,302.09	12,172	329,773	0	8,550.26		503,195
Mecklenburg	1,984,713.72	1,034,337.52	8,613	3,513,321	0	307,195.19		6,848,180
Mitchell	24,282.10	10,354.25	5,349	79,250	0	1,440.45		120,676
Montgomery	64,797.18	41,532.48	18,530	311,033	0	3,802.56		439,695
Moore	202,600.54	57,415.00	31,072	701,532	545	27,196.00		1,020,361
Nash	147,959.53	176,482.97	37,541	538,000	85,344	18,482.00	5	1,003,814
New Hanover	412,065.69	44,445.43	59,394	1,406,897	0	66,346.85		1,989,149
Northampton	49,017.97	30,981.03	5,180	142,656	0	2,836.70		230,671
Onslow	338,576.08	163,873.34	58,264	924,173	0	50,863.32		1,535,750
Orange	185,915.56	62,380.01	1,269	638,628	22,798	27,152.06		938,142
Pamilco	17,820.90	7,390.40	6,873	52,028	0	20.00		84,133
Pasquotank	87,616.67	21,563.82	22,861	354,194	0	12,571.84		498,807
Pe[illegible]	120,139.06	50,622.32	24,244	422,274	0	2,528.45		619,808
P[illegible]ans	30,006.92	13,248.80	3,372	95,312	0	1,530.16		143,470
[illegible]	80,186.23	52,699.20	3,954	227,207	0	8,106.00		372,153
P[illegible]	360,100.57	41,649.06	68,379	711,889	26,539	68,561.12	7	1,277,124
Polk	50,967.99	19,276.71	5,690	208,053	0	2,723.69		286,712
Randolph	310,110.24	122,007.95	75,430	1,943,850	0	19,098.92		2,470,497
Richmond	117,947.77	21,844.63	15,198	464,687	0	8,414.50		628,092
Robeson	206,070.55	74,997.38	17,918	1,120,118	40,606	17,012.96		1,476,722
Rockingham	191,393.37	50,414.87	43,638	519,664	132	16,076.00		821,319
Rowan	300,627.10	140,948.15	50,884	1,442,204	0	44,760.06		1,979,423
Rutherford	157,567.83	69,912.44	45,540	478,719	0	11,546.07		763,286

Amounts of Fees, Fines, and Forfeitures Collected by the Courts and Distributed to Counties and Municipalities *

W O R K S H E E T

July 1, 2005 - June 30, 2006

County	Distributed to Counties				Distributed to Municipalities			
	Facility Fees	Officer Fees	Jail Fees	Fines and Forfeitures	Facility Fees	Officer Fees	Jail Fees	TOTAL
Sampson	195,102.33	84,981.61	31,904	588,364	0	6,925.00		907,
Scotland	88,220.17	48,245.63	15,003	361,803	0	6,168.75		519,440
Stanly	165,799.71	25,257.00	18,342	607,596	0	22,616.00		839,610
Stokes	79,101.61	29,729.72	27,797	289,785	0	4,559.19		430,972
Surry	153,217.06	72,242.68	49,200	579,574	0	18,001.41		872,235
Swain	33,409.20	17,073.02	7,801	125,571	0	2,651.53		186,506
Transylvania	53,114.05	29,533.00	10,315	181,870	0	6,898.00		281,730
Tyrrell	44,000.78	19,166.03	3,391	148,254	0	0.00		214,812
Union	270,330.12	111,588.34	14,234	1,188,654	0	31,140.00		1,615,946
Vance	159,241.34	40,340.60	11,893	525,871	0	6,464.00		743,809
Wake	1,720,568.11	155,639.64	109,187	5,937,903	8,016	336,511.15		8,267,825
Warren	64,559.23	27,903.00	8,142	194,894	0	955.00		296,453
Washington	43,841.57	21,622.51	2,608	122,226	0	2,730.11		193,028
Watauga	183,967.71	47,804.84	19,008	398,757	0	20,598.16		670,136
Wayne	250,507.72	135,296.25	41,577	829,420	3,132	35,238.00		1,295,171
Wilkes	145,508.83	50,389.52	20,137	495,753	0	2,963.63		714,752
Wilson	210,464.19	158,379.41	16,381	487,819	0	22,995.39		896,039
Yadkin	85,561.71	37,506.11	21,382	244,455	0	3,168.70		392,073
Yancey	23,047.69	10,045.13	251	78,706	0	760.00		112,810
State Totals **	**19,598,505**	**7,081,834**	**2,342,779**	**61,652,524**	**484,979**	**2,384,593**	**14**	**93,545,227**

NOTE: Beginning with FY 2005-06, the AOC made changes in the generation of this report to provide better and more accurate inf

FOLLOWUP STATISTICS FOR N.C. STATE AND LOCAL FISCAL MODERNIZATION STUDY COMMISSION (from Walden)

1. Top three North Carolina public charges, FY 2004:

   public hospitals: $3.4 billion
   universities: $2.2 billion
   sewerage: $1.1 billion

   Source: Census of Governments, U.S. Census Bureau

2. North Carolina ranking on top public charges among six southeastern states, FY 2004:

   public hospitals: 1.40% of income, ranked first
   universities: 0.89% of income, ranked second (SC first)
   sewerage: 0.44% of income, ranked first

   Source: calculations from data in Census of Governments and U.S. Department of Commerce

3. NC public charges and fees as a percent of income have risen from 2% in 1977 to 3.7% in FY 2004.

   Source: calculations from data in Census of Governments and U.S. Department of Commerce

4. Adding public hospital and health spending to public education, highway, and public safety spending, NC ranks first among southeastern states in spending on these functions as a percentage of own spending.

   Source: calculations from Census of Governments

5. Reference on impact of different kinds of public expenditures on economic growth:

   Jacques Poot, "A Synthesis of Empirical Research on the Impact of Government On Long Run Growth", *Growth and Change*, Fall 2000, pp. 516-546. After analyzing scores of studies, Poot finds a large majority showing education spending having a positive impact on economic growth, a smaller majority showing infrastructure spending having a positive impact on economic growth, and a little more than half showing the tax burden associated with a negative impact on economic growth.

STATE AND LOCAL FISCAL MODERNIZATION STUDY COMMISION

Selected Individual Income Tax Information

Prepared for the December 19th Meeting on Tax Modernization

By

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Basic Income Tax Formula by State

	North Carolina	South Carolina	Virginia
Starting Point:	Federal Taxable Income	Federal Taxable Income	Federal Adj. Gross Income
Major Additions:	State & Local Taxes Non NC Muni Interest	State & Local Taxes Non SC Muni Interest Out-of-state losses	Non VA Muni Interest
Major Subtractions:	Taxable NC Refund US Gov't Interest Taxable Social Security Bailey Retirement Retirement Exclusion	Taxable SC Refund Out-of-state income 44% of LTCG US Gov't Interest Taxable Social Security Taxable Disability Income	US Gov't Interest Taxable Disability Income Charitable Mileage Numerous Specialized Most Itemized Deductions

	Georgia	Tennessee	Florida
Starting Point:	Federal Adj. Gross Income	Interest & Dividend Only	No State Income Tax
Major Additions:	Non GA Muni Interest		
Major Subtractions:	Taxable GA Refund US Gov't Interest Taxable Social Security Retirement Exclusion ($15,000) Most Itemized Deductions		

Rate Schedules (2005)

North Carolina

Single			Married Filing Jointly		
$	0 - $12,750	6%	$	0 - $21,250	6%
$	12,750 - $ 60,000	7%	$	21,250 - $100,000	7%
$	60,000 - $120,000	7.75%	$	100,000 - $200,000	7.75%
$	over $120,000	8.25%	$	over $200,000	8.25%

NOT INDEXED FOR INFLATION

South Carolina

Single			Married Filing Jointly
$	0 - $10,000	3.5%	Same as single – rates were estimated from the tax tables – no schedule was published
$	10,000 - $ 30,000	5.6%	
$	30,000 - $100,000	6.6%	
$	over $100,000	7.0%	

NOT INDEXED FOR INFLATION

Virginia

Single			Married Filing Jointly
$	0 - $3,000	2%	Same as single – one rate schedule
$	3,000 - $ 5,000	3%	
$	5,000 - $17,000	5%	
$	over $17,000	5.75%	

NOT INDEXED FOR INFLATION

	Single			Married Filing Jointly		
Georgia	$	0 - $750	1%	$	0 - $1,000	1%
	$	750 - $ 2,250	2%	$	1,000 - $ 3,000	2%
	$	2,250 - $3,750	3%	$	3,000 - $ 5,000	3%
	$	3,750 - $5,250	4%	$	5,000 - $ 7,000	4%
	$	5,250 - $7,000	5%	$	7,000 - $10,000	5%
	$	over $7,000	6%	$	over $10,000	6%

NOT INDEXED FOR INFLATION

Tennessee

6% on taxable interest and dividends in excess of $1,250 (single) or $2,500 (married).

Composition of an "Average" Federal Tax Return

By Range of Federal Adjusted Gross Income
For Federal Returns showing a North Carolina Mailing Address (see notes below)

	Adjusted Gross Income Less than $50,000		Adjusted Gross Income $50,000 to $75,000		Adjusted Gross Income $75,000 to $100,000		Adjusted Gross Income $100,000 to $200,000		Adjusted Gross Income Over $200,000	
	Average $ per Return	% of Returns Reporting	Average $ per Return	% of Returns Reporting	Average $ per Return	% of Returns Reporting	Average $ per Return	% of Returns Reporting	Average $ per Return	% of Returns Reporting
Salaries and Wages	16,958	84.7%	49,316	90.9%	68,503	91.6%	99,315	91.1%	230,305	86.0%
Taxable Interest	284	27.0%	617	57.9%	871	71.2%	1,589	82.8%	15,189	94.8%
Dividends	116	12.7%	685	28.7%	1,156	40.2%	2,722	57.5%	20,546	81.1%
Business/Profession Income (Sch. C)	652	13.8%	1,523	18.4%	2,155	19.5%	4,943	21.7%	19,371	27.6%
Net Capital Gain	135	9.8%	600	21.7%	1,374	31.2%	4,815	48.9%	84,858	79.0%
IRA income	346	5.5%	1,111	9.7%	1,702	10.7%	2,740	11.0%	4,565	10.3%
Pension income	1,624	14.7%	4,913	25.7%	6,580	27.5%	7,938	26.2%	7,913	20.9%
Social Security income (taxable portion)	258	5.9%	1,940	15.9%	2,343	15.1%	2,364	14.1%	2,991	16.4%
All other items to arrive at AGI (see note)	(534)		659		1,327		5,060		88,558	
Average Adjusted Gross Income	19,838		61,365		86,010		131,486		474,295	
Standard/Itemized Deductions & Exemptions	10,947		21,455		26,070		33,828		68,842	
Taxable Income	8,891		39,910		59,940		97,658		405,453	
Number of Tax Returns in Range	2,716,770		486,211		262,055		235,557		69,327	
Number of Returns With Negative Taxable Income	884,356		1,658		409		266		67	

Source: IRS

Data are for all federal tax returns *processed* in calendar year 2005 (primarily for tax year 2004 but could include prior years)
State is determined from the mailing address used for the federal tax return. The number of returns and dollar amounts will differ from NC data because: tax return address may be different than state of legal residence; some individuals may be required to only file a federal return or only file a NC return; some 2005 federal filings are for prior tax years; or for other reasons.

The Average Dollars per Return column represents the average amount of the applicable line item for ALL returns in the AGI range, not simply the average for those returns reporting income for that line item
"Other items to arrive at AGI" include income items such as unemployment compensation, farm income, and Schedule E income as well as all "above the line" deductions to arrive at AGI such as education deduction, retirement plan deductions, moving expenses, etc.

Answers to Chairman Rand's Question on Deadweight Tax Losses

A) At the November 29, 2006 meeting of the State and Local Fiscal Modernization Study Commission, Senator Rand asked for an example of a "deadweight" loss. This note attempts to provide examples, and reports on some rough estimates.

B) Deadweight tax losses occur because taxes tend to cause people to change their economic choices in ways that reduce tax liability. The changes take time and effort, which are costly per se. Further, when some commodities and activities are taxed less than others, people tend to substitute away from the more heavily taxed commodities. This reduces the economic value of the commodities and activities people choose. Recall the example of England's tax on windows. People built houses with fewer windows to avoid the tax. But houses with fewer windows must have lower value, otherwise the English would have built houses with fewer windows before the tax was enacted.

C) Examples:

a) Taxes may cause some folks to divert time and effort away from productive activities, such as work and saving, toward less productive activities (more time at home and consuming). Over time, these choices reduce the level of capital in the economy and the level of production: that is, they reduce the level of society's wealth and the value of what we produce, so they are deadweight losses.

b) However, if the tax system allows workers to shelter economic effort from taxes, then it is possible for workers to reduce tax liabilities without reducing work effort and saving. This occurs when middle and high income households pay tax professionals to develop tax shelters and means to shift funds into tax shelters. This diverts professional time and effort from socially productive activity toward reducing taxes. If tax shelters were removed, those professionals' resources would be spent on more productive activities. In this case, taxes may not cause social wealth and the value of production to decline. There is deadweight loss nevertheless. However, in this case, the deadweight loss is the cost of paying professionals to shelter income: society loses the value of the other services professionals could have provided.

c) Selected additional examples (there are many more):

i) Sales tax differences across states cause some folks to cross state lines to shop. Tennessee has one of the highest sales tax rates in the country. Reports are that many Tennessee Volunteers drive to Georgia, Kentucky, and Virginia to shop where sales tax rates are lower. The deadweight loss includes the time and other costs of traveling across state lines to shop.

ii) Property taxes cause some firms or folks to choose where to locate in order to lower tax rates. This point can be exaggerated. Of course, many firms and people choose where to live based on quality of work and life criteria, and not just for taxes. But deadweight loss occurs if some families choose to live in jurisdictions they would not otherwise choose, in order to pay lower property taxes, or because

they believe the government services in a jurisdiction do not compensate for the taxes owed.

iii) Labor economists have produced a good deal of evidence indicating that relatively high income tax rates tend to cause spouses of high income earners to opt out of the work force. The deadweight loss is lower income (minus the value of more time at home).

iv) Business income taxes cause some firms to invest less in capital than they would otherwise. The deadweight loss is the capital value given up because the capital stock is lower than otherwise.

D) Deadweight losses are inescapable. *No* existing tax system is efficient. Oliver Wendell Holmes said taxes are the price paid for civilized society. Deadweight losses are too. But some taxes create more deadweight loss than others, even though they raise equal revenue. Therefore, deadweight losses can be reduced by replacing a very inefficient tax with a less inefficient tax. In this way tax reform has potential to reduce deadweight losses to the minimum consistent with the other principles of tax reform, and, thereby, to improve social welfare.

E) Some Measurements of Deadweight Losses

1) A one percentage point increase in a tax rate tends to cause a more than one percentage point increase in deadweight loss. Therefore, a tax rate of 20% has a deadweight loss that is more than twice the loss from a 10% tax rate. One reason for this is that as a tax on an activity increases, people tend to substitute away from that activity, so the tax base shrinks (Dr. Roland Stephen mentioned this crucial point in his presentations). The decline in tax revenue is an additional deadweight loss. This explains why high tax rates can be very damaging, and why broadening tax bases, which permits lower rates, can be very beneficial.

a) Dr. Jerry Hausman used an economic model to estimate the deadweight loss of state and federal telecommunication taxes.[1] The deadweight loss occurs because the tax causes some people not to use cell phones, causes some people to use cell phones less than they otherwise would, and causes some people to take time and trouble to purchase wireless services in low tax states. Hausman estimates indicate that for each $1 in revenue raised by telecommunication taxes, there is about a $0.53 deadweight loss.

b) Dr. Charles Ballard and his colleagues used an economic model to estimate the excess burden of the entire U.S. tax system, as it was structured in 1973.[2] This includes federal, state, and local taxes.

i) I do not know of a similar study published since then. In 1973, federal income tax rates were much higher than now. For this reason the 1973 figures tend to overestimate current deadweight losses. State tax rates

[1] Hausman, 9/2000, Efficiency effects on the U.S. economy from wireless taxation, *National Tax Journal*, 733-42.
[2] Ballard et al., 6/1985, The total welfare cost of the United States tax system, *National Tax Journal*, 125-40.

were much lower in 1973, and spending shifts, away from goods and towards services, have become much more pronounced since 1973. This leads to an underestimate. On net, the estimates are almost surely a large overestimate, because federal tax rates have declined more than state tax rates have risen. The estimates are offered as a very rough guide to possible sizes of deadweight losses on the theory that some information is better than none.

ii) Deadweight losses of the 1973 U.S. tax system occurred because taxes caused people to shift activities and spending away from taxed activities and spending. The income tax tends to reduce work effort and saving, and causes firms to invest less. The sales tax causes people to shift away from taxed goods toward untaxed services, and to shop where sales tax rates are relatively low. Also, the tax tends to alter business use of production inputs subject to the sales tax. For example, firms would have a tax incentive to repair rather than replace worn out machinery if repairs are not taxed but new machines are taxed. Finally, the property tax affects some decisions to locate.

iii) Ballard's estimates indicate that in 1973, the entire U.S. tax system produced a deadweight loss of between 4% and 7% of Gross Domestic Product (*GDP*). This indicates a national deadweight loss of between $442.0 billion and $773.0 billion inflation-adjusted dollars.

iv) To get a very rough back-of-envelope guess at what a deadweight loss of the size measured by Ballard et al. could have meant for North Carolina, consider that in 2005 North Carolina inflation-adjusted Gross State Product was about $310 billion, or about 2.8% of inflation-adjusted *GDP*. Assuming it is reasonable to extrapolate the national deadweight loss to North Carolina, the estimates suggest a deadweight loss between $12.4 billion (that is, 0.028*$442 billion) and $21.6 billion. This is a large overestimate, first because tax structure has changed, and second because many other states had much more damaging tax structures than North Carolina in 1973. But even if these numbers overestimate the true deadweight loss by 75%, the North Carolina loss from all taxes would be between $3.1 billion and $5.4 billion.

c) A long-run economic growth model has been used to estimate deadweight losses from a typical state and local tax system.[3] Four sets of deadweight losses and a potential efficiency gain were estimated. These deadweight losses (and the gain) are measured as percentages of annual inflation-adjusted consumption. The estimates are:

i) Loss from not applying sales tax to *all* services ≈ 0.11%. In other words, in a typical state the deadweight loss resulting from taxing mostly

[3] Russo, 10/2005, An Efficiency analysis of proposed state and local sales tax reforms, *Southern Economic Journal*, 443-462.

manufactured goods, and very few services, is estimated to be worth as much as 0.11% of one year's consumption by citizens of the state.

ii) Loss from applying sales tax to business inputs ≈ 0.05%

iii) Combined loss from a) and b) ≈ 0.2%

iv) Loss from taxing personal income instead of sales ≈ 0.33% [4]

v) Based on the above results it is possible to estimate the potential gain from applying sales tax to all services, eliminating sales on business inputs, and using new sales tax revenue produced to reduce the personal income tax rate. The potential gain is 0.55% of consumption.

d) The results described above can be extrapolated to North Carolina. Inflation-adjusted annual consumption in North Carolina in 2005 was about $211 billion (about 68% of inflation-adjusted Gross State Product). The estimates are:

i) loss from not applying sales tax to *all* services ≈ $232.0 million (0.0011*$211.0 billion)

ii) loss from applying sales tax to business inputs ≈ $105.4 million

iii) combined loss from a) and b) ≈ $421.0 million

iv) loss from taxing personal income instead of sales ≈ $698.6 million

v) potential gain from applying sales tax to all services, eliminating sales on business inputs, using new revenue generated to reduce personal tax rate ≈ $1.16 billion

2) Numbers have a tendency to create a misleading appearance of precision. These estimates are only very rough guesses. Nevertheless, I believe that the fact the estimates tend to be in the hundreds of millions of dollars indicates that deadweight losses are substantial. This suggests that tax reforms that reduce deadweight losses can result in sizable increases in social welfare. It is important to note that the estimates based on state and local taxes are produced by a long-run model. This means that it could take many years to achieve efficiency gains from tax reform.

Ben Russo

[4] This can be thought of as the loss that would occur by replacing state and local sales taxes with higher income taxes. Alternatively, it can be thought of as the gain that could be realized by reducing a relatively high personal income tax and replacing lost revenue with higher sales taxes.

Excise and State & Local Sales Taxes, Compared in Selected States and Across Tax Base -04 collections in 1000s of $)

	All States	Florida	Georgia	Hawaii	Kentucky	New Mexico	North Carolina	South Carolina	Tennessee	Texas	Virginia
1) Total Tax Revenue (*TTR*)	$1,010,277,275	$53,789,454	$25,654,760	$4,812,056	$11,460,494	$5,444,158	25,012,464	$11,176,606	$14,946,638	$64,738,772	$25,002,305
2) a) Property Tax	318,242,461	18,500,291	7,844,826	720,798	2,136,455	840,068	6,093,170	3,704,419	3,585,440	28,176,329	7,715,220
b) *PT* as % of *TTR*	31.5%	34.0%	31.0%	15.0% (L)	19.0%	15.4%	24.4%	33.1%	24.0%	43.5% (H)	30.9%
3) a) Individual Income Tax	215,214,267	-	6,830,486	1,169,205	3,629,392	1,007,248	7,510,978	2,438,712	139,991	-	7,422,071
b) *IIT* as % of *TTR*	21.0%	0.0% (L)	26.6%	24.3%	31.7% (H)	18.5%	30.0%	21.8%	0.9%	0.0% (L)	29.7%
4) a) Corporate Income Tax	33,715,793	1,441,338	494,701	58,119	381,538	138,196	837,085	196,510	694,798	-	422,119
b) *CIT* as % of *TTR*	3.3%	2.7%	1.9%	1.2%	3.3%	2.5%	3.3%	1.8%	4.6% (H)	0.0% (L)	1.7%
5) a) State & Local Gen. Sales, Gr. Rcpt., Ex. Tax	360,628,892	27,407,756	9,422,758	2,605,694	4,313,337	2,627,794	8,951,045	4,011,717	8,846,308	29,656,098	7,249,089
b) *GST, GRT, ET* as % of *TTR*	36.0%	51.0%	36.7%	54.1%	38.0%	48.3%	35.8%	35.9%	59.2% (H)	45.8%	29.0% (L)
6) a) State Local General Sales Tax	244,891,334	17,996,616	7,100,684	1,900,377	2,477,717	1,955,334	5,879,211	2,842,800	7,078,574	19,152,304	3,877,631
b) *GST* as % of *TTR*	24.2%	33.5%	27.7%	39.5%	21.6%	35.9%	23.5%	25.4%	47.4% (H)	29.6%	15.5% (L)
7) State General Sales Tax Rate	Median = 5.5%	6.0%	4% (L)	4% (L)	6.0%	5.0%	4.25%	5.0%	7% (H)	6.25%	4% (L)
8) Maximum Local General Sales Tax Rate	Highest = 8% in Ala.	1.5%	3.0%	0.0%	0.0%	2.8% *	2.5%-3%	2.0%	2.75%	2.0%	1.0%
9) Special Sales Tax Treatment											
a) prescription drugs	44 states exempt	E	E	E	E	E	E	E	E	E	E
b) motor fuel	35 states exempt	Taxed	Taxed	Taxed	E	E	E	E	E	E	E
c) residential electricity & natural gas	32 states exempt	E	Taxed	Taxed	E	Taxed	Taxed	E	E	E	E
d) food for home consumption	29 states exempt	E	State E	Taxed **	E	E ***	State E	Taxed ****	Taxed ****	E	Taxed ****
10) Estimates of 'Broadness' of Sales Tax Base											
a) tax base as % of consumption spending	0.58	0.77	0.65	1.46 (H)	0.47	0.97	0.64	0.64	0.72	0.53	0.46 (L)
b) sales tax revenue per person, per 1¢ of tax	152.95	172.41	201.06	376.16 (H)	99.60 (L)	205.50	152.97	135.44	171.36	136.25	129.95
11) # of services taxed (per Fed. of Tax Admin.)	Median = 55	62	36	160 (H)	29	156	30	34	67	81	18 (L)
12) % of Sales Tax from Business Inputs	41%	50%	36%	72% (H)	46%	50%	38%	39%	37%	47%	30% (L)
13) Excise Tax on Cigarettes (per pack)	Highest = $2.46 in RI	$0.34	$0.37	$1.40	$0.03	$0.91	$0.35	$0.07	$0.20	$0.41	$0.30
14) Excise Tax on Gasoline (per gallon)	Highest = $0.31 in RI	$0.145	$0.075	$0.160	$0.174	$0.000	$0.269	$0.160	$0.214	$0.200	$0.175

NOTES: * Increased from 2.25%, per Sales Tax Institute; ** Income tax credit; *** Exemption introduced in 2006; **** Food taxed @ low rate

SOURCES: 2003-04 collections taken from Census Bureau (CB figures sum state and local revenues and facilitate comparison with national figures); state & local general sales and excise tax rates from Table 27, 2006 Statistical Abstract of North Carolina Taxes; Bureau of Economic Analysis; Sales Tax Institute; Federation of Tax Administrators; Sales Taxation, J. Due and J. Mikesell; R. Ring, 1999, National Tax Journal; State and Local Public Finance, R. Fisher

Personal Income					
Geographic Area	Population - 7/1/2004	Personal Income - 2004	Per Capita Personal Income - 2004	Per capita personal income, percent of US	Personal income, percent change (average annual growth rate - 1969-2004)
Alamance	138,452	3,740,467,000	27,016	82	7.2
Ashe	25,287	618,298,000	24,451	74	8.2
Buncombe	215,705	6,047,658,000	28,037	85	7.8
Carteret	61,812	1,803,484,000	29,177	88	9.2
Catawba	149,474	4,159,651,000	27,829	84	7.6
Forsyth	320,780	10,770,332,000	33,575	102	7.7
Montgomery	27,261	643,768,000	23,615	71	7.5
Northampton	21,504	539,191,000	25,074	76	7.4
Robeson	126,263	2,477,349,000	19,621	59	7.8
Wake	719,733	26,403,048,000	36,685	111	10.4
North Carolina	8,540,468	250,426,537,000	29,322	89	8.3

Figures from Bureau of Economic Analysis - Regional Economic Accounts – Local Area Annual Estimates – Interactive Tables – Personal Income, Population, Per Capita Personal Incomes – 2004 - http://www.bea.gov/bea/regional/reis/default.cfm?catable=CA1-3&section=2 (Estimates for 2004 released on April 25, 2006.).

North Carolina Department of State Treasurer - Financial Information – Counties – 7/1/2005 – 6/30/2006 – Cash, Investments, and Financing - Property Tax Assessed Valuation Statistics

Geographic Area	Population 7/1/2005	Latest year of Revaluation	January 1, Prior Year Assessed Valuation (2005)	January 1, Prior Year Assessed Valuation (2005) per capita	Tax Rate	Assessment - to-Sales Ratio	Assessed Valuation adjusted for Assessed to Sales Ratio	Tax Rate Adjusted	Assessed Valuation adjusted for Assessed to Sales Ratio per capita
Alamance	138,572	2001	9,914,522,051	71,548	0.5625	94.91	10,446,235,435	0.5339	75,385
Ashe	25,500	1998	1,995,075,036	78,238	0.6100	58.95	3,384,351,206	0.3596	132,720
Buncombe	216,738	2002	18,925,154,140	87,318	0.5900	82.61	22,909,035,395	0.4874	105,699
Carteret	62,760	2001	8,143,029,955	129,749	0.4200	77.79	10,467,964,976	0.3267	166,794
Catawba	149,032	2003	12,984,699,748	87,127	0.4900	96.47	13,459,831,811	0.4727	90,315
Forsyth	326,340	2005	28,383,368,962	86,975	0.6660	100.00	28,383,368,962	0.6660	86,975
Montgomery	27,359	2004	2,099,419,662	76,736	0.5800	83.25	2,521,825,420	0.4829	92,175
Northampton	21,568	2001	1,222,319,688	56,673	0.8800	71.23	1,716,018,093	0.6268	79,563
Robeson	127,695	2005	5,187,491,891	40,624	0.8000	97.30	5,331,440,792	0.7784	41,751
Wake	755,034	2000	74,602,470,725	98,807	0.6040	89.16	83,672,578,202	0.5385	110,820
North Carolina	8,682,094	N/A	718,605,832,500	82,769	0.6504	91.33	786,823,423,300	0.5941	90,626

Figures from North Carolina Dept. of State Treasurer - State & Local Government Finance Division - North Carolina County and Municipal Financial Information – Counties - http://www.nctreasurer.com/lgc/units/unitlistjs.htm (Last updated 11/20/06).

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Answers to Chairman Gerlach's Question on Alabama's Tax Reform Attempt

A) At the November 29, 2006 meeting of the State and Local Fiscal Modernization Study Commission, Chairman Gerlach asked for information about Alabama's attempt at tax reform. This note describes (as far as I am able to ascertain) events in Alabama, as well as more notable state tax changes since 1987.

B) In 2002, a University of Alabama Law School professor (Susan Hamill) objected to Alabama's income tax on poor households, on ethical and religious grounds. At that time a family of four with $4,600 or more income was liable for Alabama personal income tax.[1] In response, Governor Riley proposed a change in Alabama's Constitution and tax laws (Amendment One, on Alabama's Sept. 2003 ballot) that would have: increased the income tax threshold from $4,600 to more than $17,000, eliminated Alabama's federal income tax deduction, provided property tax relief for small family farms, increased cigarette taxes, increased sales taxes on cars and lawn mowers and on some services (E.G. car repairs). Alabama overwhelmingly voted against Amendment One.

C) Dr. Jim Seroka, Director for the Center for Government Services at Auburn University says Governor Riley's plan would have increased tax revenue by more than $1.0 billion.[2] When the plan failed, Alabama had to cut state agency appropriations an average of 18%. Seroka reports on a survey he conducted after Amendment One failed. He says of those who voted against the proposal 68% objected to the higher tax on autos and light trucks, 63% objected to increasing Alabama state real property tax assessment to 100% of market value, 61% opposed Governor Riley's plan to increase revenue more than was necessary to balance the budget, and 56% distrusted Alabama's plans to allocate the new revenues. Seroka says of those who supported the proposal, 66% were afraid of teacher layoffs, 52% were afraid of senior center closures, 59% were concerned about unfairness of Alabama's tax system, and 59% liked the promise of a new college scholarship fund based on achievement.

D) In April 2006, Governor Riley signed a law raising the income tax threshold to $12,600 for a family of four, to take effect in 2007.

E) Additional state tax law changes since 1987 (these are only the ones I am aware of. There probably are many more)

1987: Minnesota: imposed a stamp tax on illegal drugs, and extended its general sales tax to some services.

1989: North Carolina began using federal 'Taxable Income' as its income tax base.

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[1] Alabama's income tax was established in 1935. A married couple received an exemption of $3,000, with a $300 exemption for each dependent, giving an income tax threshold of $3,600 for a family of four (no standard deduction was allowed until 1951). $3,600 in 1935 had the same inflation-adjusted value that $37,656.90 has today. In other words, $3,600 in 1935 bought what it would take $37,656.90 to buy today. In 1935 Alabama's income tax was paid only by 7,000 high income households.

[2] Seroka, 12/2003, Alabama's Tax Reform: What Went Wrong and Why? http://web6.duc.auburn.edu/outreach/cgs/AllDocuments/SRL_Alabamataxvote2003.pdf

1990: Massachusetts extended its sales and use tax to business and professional services. It repealed the tax before any revenue was collected in deference to then new Governor Weld, who opposed the tax.

1991: Connecticut enacted a new personal income tax, reduced business income tax rates, and increased some tax credits such as one on capital investment.

Texas "reformed" its franchise tax by making it depend not only on a company's capital stock but also on its net income. It eliminated its corporate income tax.[3]

1992: Colorado amended its constitution, limiting revenue growth to growth in population and the rate of inflation (the "Taxpayer Bill of Rights"). Other states have since passed similar constraints on revenue growth.

1993: Michigan eliminated its local school property taxes.

New Mexico (one of the few states that taxes many services) repealed its sales tax credit for food and medical expenses. New Mexico used the $20 million saving to increase Medicaid eligibility and aid to low income families.

1994: Michigan amended its constitution to approve a shift in education funding to state sources, reduced the state income tax, increased sales and cigarette taxes, enacted new state property and real estate conveyance taxes, and capped property tax assessment increases.

1995-1998: North Carolina enacted the William S. Lee Quality Jobs and Business Expansion Act, which created business tax credits; phased out the state portion of the sales tax on food; and eliminated its intangibles and inheritance taxes.

1998: In response to a state Supreme Court ruling, Vermont replaced local school district property taxes with a statewide tax on property or income, depending on the type of property and income.

1999: Michigan: passed a gradual repeal of its Single Business Tax [a 23 year phase out with a moratorium if Michigan's budget stabilization fund (its rainy day fund) falls below $250 million].[4]

2001: Minnesota eliminated its state general education property tax and created a new statewide property tax on business and seasonal recreational property (dedicated to education).

2005: Voters passed a 5 year override on the revenue growth limits Colorado approved in 1992.

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[3] Steven Gold (Urban Institute) has written that Texas merely renamed its corporate income tax 'franchise tax.'
[4] The Single Business Tax is one form of Value Added Tax ('value added' is the difference between a firm's total revenue and its cost for inputs purchased from other firms).

New York switched from a four factor apportionment formula to one factor.

Ohio reduced its personal income tax rate from 7.5% to 6%; began phasing out its tax on tangible personal property and inventory, as well as the corporate franchise tax (with exceptions for bank subsidiaries and insurance companies); increased the business real estate tax; increased the sales tax rate; increased its cigarette tax; and enacted a business privilege tax on gross receipts (the "Commercial Activity Tax"). CAT taxes all business receipts. The Ohio Business Development Coalition argues that Ohio's tax reform has worked. [Go to http://www.ohiomeansbusiness.com/]

2006: The single most pronounced state tax trend in the past ten years may be the shift from local property taxes to state-wide taxes, to finance schools. Arizona, Indiana, New York, Pennsylvania, and Rhode Island expanded property tax breaks. New Jersey increased sales taxes to finance property tax cuts. Texas and South Carolina raised other taxes to finance property tax cuts.

Indiana will switch to a one factor apportionment formula.

Utah lowered its income tax rate to 5.35% and eliminated deductions. The new "flat tax" is optional. Taxpayers can pay the lower flat tax rate but forego deductions, or can pay a higher rate (6.98%) and take deductions. Tax liability is the lower of the two.

2007: 1,047 online retailers have agreed to begin collecting Vermont's use tax. They will have amnesty from back taxes owed.

Ben Russo

Below are a few tables and charts comparing water and sewer revenues and expenditures in North Carolina with those in five other southeastern states—Georgia, South Carolina, Tennessee, Virginia and West Virginia. The first table presents aggregate local revenue and expenditures for water and sewer infrastructure and operating expenses for fiscal 2001-2002. The second table details current water and sewer rates charged by a few selected cities in each of the six states. The charts depict state funding for water and sewer infrastructure from 2000-2003 for several states, including the six southeastern states.

Comparison of Water and Sewer Aggregate Local Revenue and Expenditures

The following table details aggregate local government revenue and expenditures for water and sewer for six southeastern states during 2001-2002. The revenue figures include only moneys raised at the local government level. The expenditure figures include capital and operational costs. The data was compiled from the 2002 U.S. Census of Governments. Dollar amounts are in thousands.

	North Carolina	Georgia	South Carolina	Tennessee	Virginia	West Virginia
Local Revenues						
Water & Sewer	$1,409,342	$1,754,254	$825,235	$1,119,140	$1,528,364	$264,621
Special Assessments*	$13,889	$20,584	$26,238	$17,105	$72,521	$10,160
Total	$1,423,231	$1,774,838	$851,473	$1,136,245	$1,600,885	$274,781
Expenditures						
Water & Sewer**	$1,837,762	$3,583,550	$958,951	$1,287,851	$1,718,661	$339,864

Explanation of Categories:

Revenue

- *Sewer:* Figures include local government revenue from charges for sewage collection and disposal and sewer connection fees. They do not include moneys raised from impact fees.
- *Water:* Figures include local government revenue from the operations of public water supply systems, such as sale of water to residential, industrial, and commercial customers, connection and "tap" fees, sprinkler fees, meter inspection fees, late payment penalties, and other operations revenue. The figures do not include water impact fees and other special assessments.
- *Special Assessments:* Figures include local government revenue from compulsory contributions and reimbursements from owners of property that benefit from specific public improvements; impact fees to fund extension of water and sewer infrastructure. *The figures also include revenue from assessments on roads and other infrastructure facilities in new developments.

Expenditure

- *Sewer:* Figures include local government expenditures on the provision, maintenance, and operation of sanitary and storm sewer systems and sewage disposal and treatment facilities—for example, construction and maintenance of sanitary sewer lines; sewer cleaning; lift or pump stations; sewage treatment plants; water pollution control plants; storm drains that are not connected with highway projects; systems for the collection and disposal of storm runoff; and any intergovernmental payments for such activities.
- *Water:* Figures include local government expenditures for the operation, maintenance and construction of public water supply systems, including production, acquisition, and distribution of water to the general public or to other public or private utilities, for residential, commercial or industrial use. **Because of the way the data is reported, there are some capital costs for water infrastructure that are not reflected in these figures.

Comparison of Water and Sewer Utility Fees for Selected Cities

The following table details monthly residential water and sewer utility fees for selected cities in the six southeastern states. It also includes some statistical data for purposes of comparison. The cities in each state were selected to represent a range of population and median income levels across the six states. It is important to note that in each state there are different legal structures for providing water and sewer services, making comparisons among and within the states difficult. Most entities charge a monthly fixed or minimum fee to all customers and then have a variable rate depending on usage. The variable rate may have multiple tiers—either increasing block (where the per unit rate increases with consumption level) or decreasing block (where the per unit rate decreases with consumption level). Consumption levels typically are measured in Ccf units or gallons. (One Ccf is defined as 100 cubic feet—equal to 748 gallons of water.) In jurisdictions with tiered rate structures, the ranges of rates per usage are indicated below. Each jurisdiction sets its block rates at different consumption levels, however, which are not reflected in the chart. The inside city rate is the rate charged to resident customers; the outside city rate is that charged to non-resident customers.

Note that this chart only reflects rates charged to single family, residential customers. Many jurisdictions have separate rates for commercial or industrial customers, irrigation customers and multi-unit dwellings. Most jurisdictions also charge additional impact or capacity fees and connection fees for new customers, as well as reconnection fees and various penalties for late payments. The data was compiled from the U.S. Census Bureau and from published water and sewer rates in the various cities.

	Population Estimate (2003)	Median Household Income (1999)	Land Area in Square Miles (2000)	Water Residential Inside City Monthly Rates (2006)	Water Residential Outside City Monthly Rates (2006)	Sewer Residential Inside City Monthly Rates (2006)	Sewer Residential Outside City Monthly Rates (2006)
North Carolina							
Charlotte	584,658	$46,975	242	$1.80 fixed + $1.28-$4.14 per usage		$1.80 fixed + $2.98 per usage (up to maximum of 18 Ccf)	
Greensboro	229,110	$39,661	105	$4.40 fixed + $1.47-$3.40 per usage	$8.80 fixed + $2.94-$6.80 per usage	$4.40 fixed + $2.55 per usage	$8.80 fixed + $5.10 per usage
Gastonia	67,781	$36,924	46	$3.55 fixed + $2.69-$2.01 per usage	$3.55 fixed + $5.39-$4.05 per usage	$3.87 fixed + $3.31 per usage	$3.87 fixed + $5.76 per usage

	Population Estimate (2003)	Median Household Income (1999)	Land Area in Square Miles (2000)	Water Residential Inside City Monthly Rates (2006)	Water Residential Outside City Monthly Rates (2006)	Sewer Residential Inside City Monthly Rates (2006)	Sewer Residential Outside City Monthly Rates (2006)
Jacksonville	67,386	$32,544	44	$8.48 fixed + $.17-$.22 per usage (above 2,000 gallons)	200% of city rates	$20.64 fixed + $.55-$.65 per usage (above 2,000 gallons)	200% of city rates
Kannapolis	38,178	$35,532	30	$3.30 fixed + $4.92 per usage	$3.96 fixed + $5.90 per usage	$3.80 fixed + $4.82 per usage	$3.80 fixed + $4.82 per usage
Georgia							
Atlanta	423,019	$34,770	132	$3.30 fixed + $1.29-$3.10 per usage + $.15 per usage nat'l security surcharge	$3.30 fixed + $1.76 -$3.75 per usage + $.15 per usage nat'l security surcharge	$3.30 fixed +$4.90-$7.89 per usage + $.15 per usage nat'l security surcharge	$3.30 fixed + $4.90-$7.89 per usage + $.15 per usage nat'l security surcharge
Savannah	127,573	$29,038	75	$5.53 fixed + $.25-$.34 per usage	$8.29 fixed + $.37-$.51 per usage	$4.40 fixed + $.76-$.98 per usage	$6.60 fixed + $1.18-$1.47 per usage
Marietta	61,282	$40,645	22	$9.92 fixed + $2.36 per usage (over 2,000 gallons)		$10.71 fixed + $5.35 per usage (over 2,000 gallons)	
East Point	37,220	$31,874	14	$6.39 fixed + $2.04-$2.26 per usage	Charged 1.5 times the rate charged city residents	$4.95 fixed + $2.67 per 1000 gallons	
Gainesville	29,806	$36,605	27	$8.67 fixed + $6.08-$1.84 per usage	$16.32 fixed + $11.52-$3.48 per usage	$4.60 fixed + $4.60 per usage (based on 85% of monthly water readings)	
South Carolina							
Columbia	117,357	$31,141	125	$4.70 fixed + $1.48 per usage (above 3 Ccf)	$$9.42 fixed + $2.68 per usage (above 3 Ccf)	$4.16 fixed + $2.20 per usage (above 3 Ccf)	$4.16 fixed + $3.16 per usage (above 3 Ccf)
Rock Hill	56,114	$37,336	31	$9.28 fixed +	$19.01 fixed +	$13.99 fixed +	$28.01 fixed +

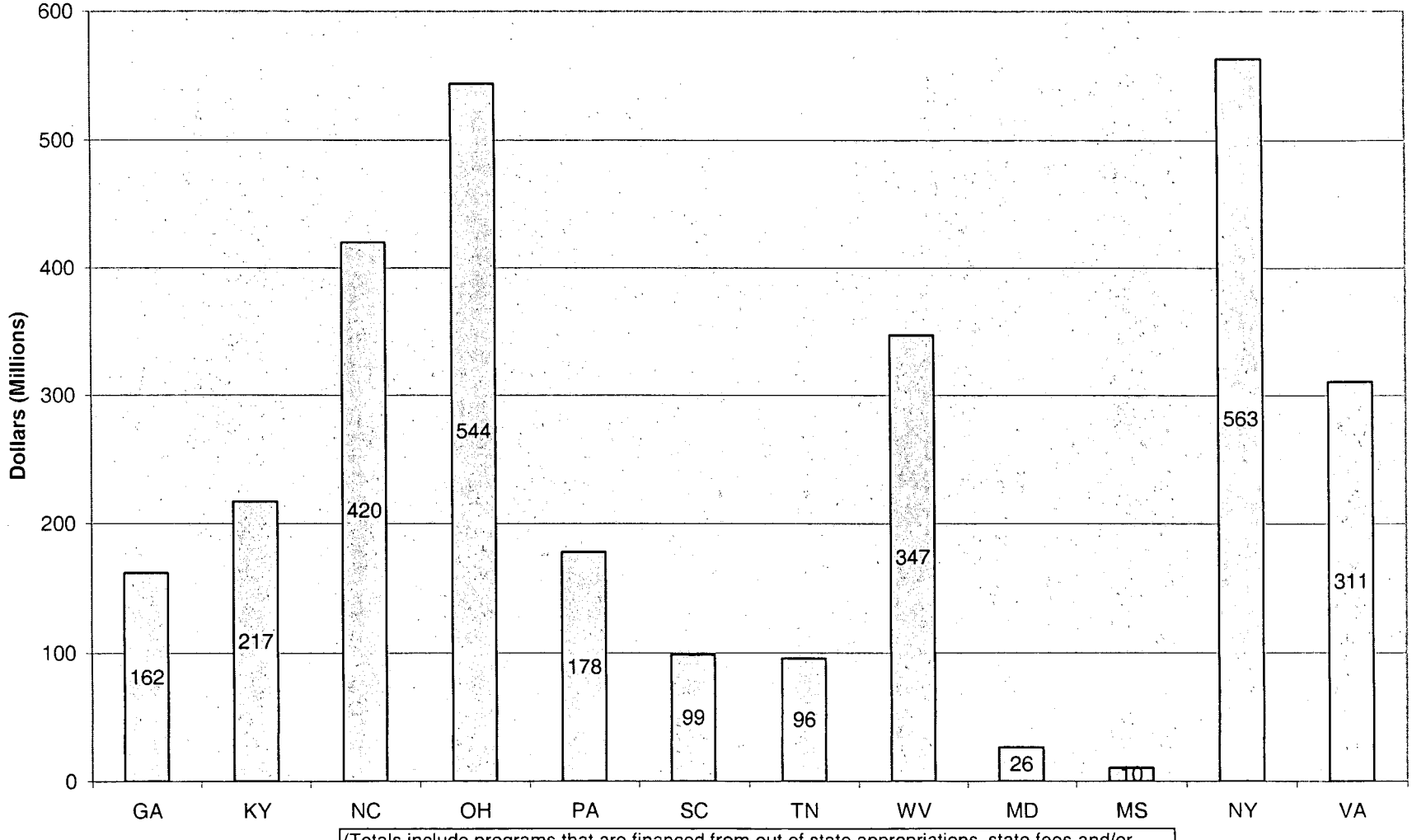
	Population Estimate (2003)	Median Household Income (1999)	Land Area in Square Miles (2000)	Water Residential Inside City Monthly Rates (2006)	Water Residential Outside City Monthly Rates (2006)	Sewer Residential Inside City Monthly Rates (2006)	Sewer Residential Outside City Monthly Rates (2006)
				$.00123 per usage	$.00271 per usage	$.00278 per usage ($48.79 maximum)	$.00487 per usage ($88.95 maximum)
Summerville	31,734	$43,635	15	$8.00 fixed + $1.50 per usage (above 2,000 gallons)	$13.00 fixed + $2.20 per usage (above 2,000 gallons)	$9.79 fixed + $4.51 per usage ($63.91 maximum)	
Florence	30,267	$35,388	18	$10.27 fixed + $1.43 per usage	$13.65 fixed + $2.15 per usage	$16.82 fixed + $1.77 per usage	$23.14 fixed + $2.66 per usage
Aiken	26,456	$44,172	16	$4.96 fixed + $.76-$1.37 per usage (rates also vary seasonably)	$9.92 fixed + $1.52-$2.40 per usage (rates also vary seasonably)	$7.35 fixed + $1.48 per usage	$14.70 fixed + $2.96 per usage
Tennessee							
Memphis	645,978	$32,285	279	$4.81 fixed + $1.14 per usage	$6.70 fixed + $1.78 per usage		
Murfreesboro	78,074	$39,705	39	$7.83 fixed + $2.61 per usage (above 3 Ccf)	Rates are 50% higher outside the city	$7.83 fixed + $.70 per usage (above 3 Ccf)	Rates are 50% higher outside the city
Bartlett	42,245	$66,369	19	$4.00 fixed + $1.24-$1.14 per usage (above 2,000 gallons)	$6.00 fixed + $1.86-$1.71 per usage (above 2,000 gallons)	$4.27 fixed + $1.13 per usage (above 2,000 gallons)	$6.27 fixed + $1.23 per usage (above 2,000 gallons)
Smyrna	30,172	$44,405	23	$6.75 fixed + $2.03-$2.46 per usage (above 2,000 gallons)	$8.86 fixed + $3.05-$3.70 per usage (above 2,000 gallons)	$9.03 fixed + $1.92 per usage (above 2,000 gallons)	$13.48 fixed + $2.76 per usage (above 2,000 gallons)
Oak Ridge	27,338	$41,950	86	$8.01 fixed + $3.10-$1.56 per usage (above 2,000 gallons)		$11.50 fixed + $4.13-$5.55 per usage (above 2,000 gallons)	
Virginia							
Virginia Beach	439,467	$48,705	248	$4.10 fixed + $3.70 per usage		$16.88 fixed	

	Population Estimate (2003)	Median Household Income (1999)	Land Area in Square Miles (2000)	Water Residential Inside City Monthly Rates (2006)	Water Residential Outside City Monthly Rates (2006)	Sewer Residential Inside City Monthly Rates (2006)	Sewer Residential Outside City Monthly Rates (2006)
Chesapeake	210,834	$50,743	341	$15.50 fixed + $3.23 per usage (above 3 Ccf)		$5.95 fixed + $.73 per usage (above 3 Ccf)	
Portsmouth	99,617	$33,742	33	$5.00 fixed + $3.38 per usage		$2.30 fixed + $2.65 per usage	
Harrisonburg	41,170	$29,949	18	$6.10 fixed + $2.17-$1.83 per usage (above 3,000 gallons)	$11.69 fixed + $4.16-$3.48 per usage (above 3,000 gallons)	$3.18 fixed + $.90-$1.18 per usage (above 3,000 gallons)	$5.31 fixed + $1.45-$2.01 per usage (above 3,000 gallons)
Blacksburg	40,066	$22,513	19	$2.10 fixed + $3.06 per usage	$3.68 fixed + $5.36 per usage	$2.13 fixed + $3.48 per usage	$3.73 fixed + $6.09 per usage
West Virginia							
Wheeling	30,096	$27,388	14	$4.94 fixed + $2.30-$1.18 per usage (above 1,000 gallons)		$3.04-$2.36 per usage ($5.64 minimum)	
Parkersburg	32,100	$26,990	12			$10.84 fixed + $4.30 per usage	
Morgantown	27,969	$20,649	10	$4.18 fixed + $2.09-$1.14 per usage		$6.70 fixed + $3.35-$3.48 per usage	

Comparison of State Funding for Water and Sewer Infrastructure

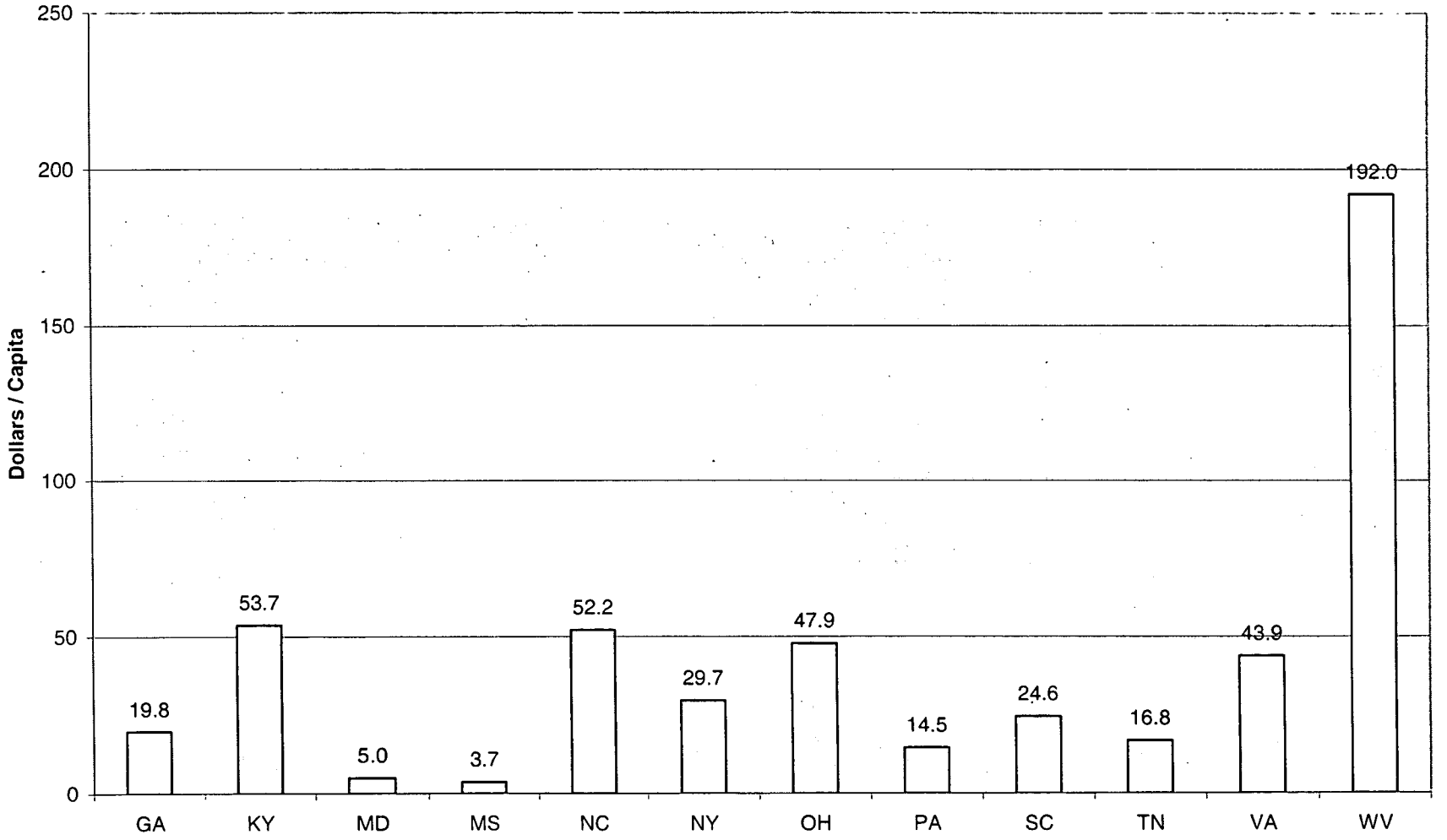
The following charts provide a comparison of state funding for water and sewer infrastructure from 2000-2003 for several states, including the six southeastern states referenced above. Funding totals include state programs that are financed out of state appropriations, state fees and/or bond issues. They do not include state matching funds that go toward federal programs, such as state revolving funds. Population statistics are based on 2000 census data. The data was compiled by the N.C. Environmental Center.

State Program Funding for Water and Sewer Infrastructure (2000-2003)



(Totals include programs that are financed from out of state appropriations, state fees and/or state bond issues and does not include state funds that go toward federal programs (e.g. SRF).)

Per Capita State Program Funding for Water and Sewer Infrastructure (2000-2003)
(Population Data Source: US 2000 Census)



(Totals include programs that are financed from out of state appropriations, state fees and/or state bond issues and does not include state funds that go toward federal programs (e.g. SRF).)

NORTH CAROLINA JUDICIAL BRANCH OF GOVERNMENT
COUNTY FACILITY FEES
2005-2006

COUNTY	Superior Court Criminal	Superior Court Civil	Superior Court Special Proceedings	Superior Court Estates	District Court Criminal	District Court Civil	Magistrate Criminal	Magistrate Civil	2005 - 2006 Total Facility Fees by County	2005 - 2006 Facility Fee Interest Earned by County	TOTAL FACILITY FEES COUNTY AND INTEREST
ALAMANCE	$15,563.01	$5,344.00	$1,720.00	$5,112.25	$206,763.82	$26,832.00	$0.00	$40,920.00	$ 302,255.08	$0.00	$ 302,255.08
ALEXANDER	$1,354.21	$912.00	$470.00	$0.00	$23,945.99	$5,248.00	$0.00	$5,976.00	$ 37,906.20	$76.04	$ 37,982.24
ALLEGHANY	$567.40	$304.00	$210.00	$775.57	$10,736.60	$2,608.00	$0.00	$1,824.00	$ 17,025.57	$64.11	$ 17,089.68
ANSON	$3,937.00	$864.00	$360.00	$950.00	$41,100.00	$3,750.00	$228.00	$4,122.00	$ 55,311.00	$0.00	$ 55,311.00
ASHE	$1,336.00	$575.00	$299.00	$1,310.00	$21,340.33	$4,528.00	$0.00	$3,564.00	$ 32,952.33	$165.78	$ 33,118.11
AVERY	$1,291.79	$1,008.00	$270.00	$649.22	$19,348.70	$2,320.00	$0.00	$1,944.00	$ 26,831.71	$91.51	$ 26,923.22
BEAUFORT	$7,933.50	$2,144.00	$340.00	$1,905.00	$115,937.88	$13,088.00	$0.00	$10,008.00	$ 151,356.38	$212.13	$ 151,568.51
BERTIE	$2,089.97	$960.00	$350.00	$1,700.00	$66,087.42	$4,736.00	$0.00	$6,120.00	$ 82,043.39	$0.00	$ 82,043.39
BLADEN	$1,642.18	$2,127.00	$210.00	$970.00	$72,494.96	$6,712.00	$12.00	$7,356.00	$ 91,524.14	$198.46	$ 91,722.60
BRUNSWICK	$5,584.00	$5,646.00	$1,590.00	$4,019.86	$90,264.00	$19,543.00	$24.00	$14,796.00	$ 141,466.86	$26,527.81	$ 167,994.67
BUNCOMBE	$12,849.12	$11,536.00	$3,960.00	$9,798.95	$237,970.00	$49,280.00	$2,208.00	$47,400.00	$ 375,002.07	$0.00	$ 375,002.07
BURKE	$9,968.19	$2,944.00	$1,310.00	$4,027.59	$124,877.95	$17,472.00	$96.00	$20,652.00	$ 181,347.73	$5,885.13	$ 187,232.86
CABARRUS	$22,213.78	$5,984.00	$2,260.00	$4,980.00	$315,889.18	$36,922.00	$6,650.00	$39,132.00	$ 434,030.96	$4,794.60	$ 438,825.56
CALDWELL	$7,372.67	$2,928.00	$1,310.00	$5,104.31	$92,441.53	$17,072.00	$4,236.00	$16,836.00	$ 147,300.51	$428.05	$ 147,728.56
CAMDEN	$1,012.25	$320.00	$170.00	$390.00	$26,488.63	$1,312.00	$0.00	$1,104.00	$ 30,796.88	$138.43	$ 30,935.31
CARTERET	$5,408.00	$3,984.00	$1,020.00	$3,684.00	$144,421.00	$15,808.00	$0.00	$13,404.00	$ 187,729.00	$22,425.85	$ 210,154.85
CASWELL	$2,878.85	$880.00	$340.00	$1,260.00	$35,777.68	$4,384.00	$0.00	$4,176.00	$ 49,696.53	$3,032.00	$ 52,728.53
CATAWBA	$8,770.00	$8,895.00	$2,780.00	$7,200.00	$123,892.00	$33,722.00	$330.00	$19,374.00	$ 204,963.00	$785.72	$ 205,748.72
CHATHAM	$1,823.00	$2,000.00	$990.00	$2,498.22	$45,720.00	$7,200.00	$72.00	$4,469.00	$ 64,772.22	$13,648.76	$ 78,420.98
CHEROKEE	$2,066.61	$1,248.00	$510.00	$1,017.65	$46,327.40	$6,288.00	$0.00	$3,792.00	$ 61,249.66	$249.84	$ 61,499.50
CHOWAN	$1,797.85	$464.00	$170.00	$964.00	$20,685.00	$2,400.00	$0.00	$3,108.00	$ 29,588.85	$180.69	$ 29,769.54
CLAY	$274.47	$368.00	$150.00	$430.00	$11,065.66	$1,696.00	$0.00	$1,764.00	$ 15,748.13	$78.77	$ 15,826.90
CLEVELAND	$5,336.77	$3,296.00	$1,420.00	$4,112.71	$125,904.69	$25,344.00	$24.00	$31,908.00	$ 197,346.17	$1,458.87	$ 198,805.04
COLUMBUS	$2,988.77	$3,744.00	$810.00	$1,880.00	$89,022.75	$12,163.00	$1,440.00	$9,252.00	$ 121,300.52	$261.21	$ 121,561.73
CRAVEN	$5,730.67	$4,368.00	$1,620.00	$3,288.40	$158,502.94	$24,910.00	$4,039.00	$22,652.00	$ 225,111.01	$461.41	$ 225,572.42
CUMBERLAND	$11,807.08	$12,256.00	$6,750.00	$8,043.25	$151,930.98	$92,736.00	$0.00	$144,240.00	$ 427,763.31	$2,394.90	$ 430,158.21
CURRITUCK	$2,964.00	$1,008.00	$260.00	$790.00	$82,754.56	$3,024.00	$0.00	$4,980.00	$ 95,780.56	$1,120.24	$ 96,900.80
DARE	$12,830.69	$2,960.00	$390.00	$1,316.00	$148,150.15	$6,816.00	$0.00	$6,819.00	$ 179,281.84	$32,701.54	$ 211,983.38
DAVIDSON	$7,597.06	$4,704.00	$2,320.00	$6,903.79	$165,527.45	$37,680.00	$517.00	$43,944.00	$ 269,193.30	$872.38	$ 270,065.68
DAVIE	$1,518.27	$1,424.00	$410.00	$2,070.00	$51,986.14	$5,568.00	$0.00	$5,328.00	$ 68,304.41	$0.00	$ 68,304.41
DUPLIN	$5,696.50	$2,016.00	$670.00	$2,414.29	$138,947.52	$7,904.00	$1,728.00	$9,720.00	$ 169,096.31	$6,200.85	$ 175,297.16
DURHAM	$5,659.86	$12,448.00	$4,570.00	$8,881.43	$279,293.07	$50,250.00	$264.00	$194,114.00	$ 555,480.36	$4,377.76	$ 559,858.12
EDGECOMBE	$3,937.26	$2,272.00	$1,176.07	$1,830.00	$92,406.04	$12,896.00	$744.00	$19,138.00	$ 134,399.37	$0.00	$ 134,399.37
FORSYTH	$9,095.61	$18,944.00	$5,850.00	$16,240.00	$469,294.00	$84,316.00	$0.00	$172,219.00	$ 775,958.61	$77,427.32	$ 853,385.93
*FRANKLIN	$3,185.89	$2,144.00	$630.00	$1,590.00	$75,672.67	$14,288.00	$0.00	$10,860.00	$ 108,370.56	$233.44	$ 108,604.00
GASTON	$18,719.73	$9,600.00	$3,512.00	$7,566.20	$229,954.75	$43,503.00	$28,800.00	$74,952.00	$ 416,607.68	$42,058.41	$ 458,666.09
GATES	$617.08	$288.00	$200.00	$620.00	$24,756.23	$1,840.00	$0.00	$2,628.00	$ 30,949.31	$0.00	$ 30,949.31
GRAHAM	$641.57	$352.00	$100.00	$380.00	$6,879.22	$1,232.00	$0.00	$852.00	$ 10,436.79	$3,036.71	$ 13,473.50
GRANVILLE	$4,059.00	$1,984.00	$440.00	$1,945.00	$79,522.00	$8,944.00	$564.00	$14,040.00	$ 111,498.00	$439.61	$ 111,937.61
GREENE	$1,987.71	$736.00	$260.00	$720.00	$33,690.49	$1,888.00	$0.00	$3,468.00	$ 42,750.20	$93.44	$ 42,843.64

Report includes facility fee interest for 2000-01 of $576,512.05.

COUNTY FACILITY FEES
2005-2006

COUNTY	Superior Court Criminal	Superior Court Civil	Superior Court Special Proceedings	Superior Court Estates	District Court Criminal	District Court Civil	Magistrate Criminal	Magistrate Civil	2005 - 2006 Total Facility Fees by County	2005 - 2006 Facility Fee Interest Earned by County	TOTAL FACILITY FEES COUNTY AND INTEREST
GUILFORD	$30,373.00	$28,936.00	$6,940.00	$16,289.16	$672,544.58	$102,441.00	$0.00	$253,608.00	$ 1,111,131.74	$4,925.74	$ 1,116,057.48
HALIFAX	$3,972.83	$2,128.00	$850.00	$5,297.45	$108,877.94	$10,893.74	$12.00	$15,624.00	$ 147,655.96	$264.56	$ 147,920.52
HARNETT	$4,880.52	$4,846.00	$2,350.00	$3,444.05	$91,552.32	$19,574.00	$0.00	$19,805.00	$ 146,451.89	$7,097.24	$ 153,549.13
HAYWOOD	$4,915.40	$2,192.00	$552.72	$2,250.00	$85,778.94	$12,874.00	$0.00	$8,664.00	$ 117,227.06	$16,768.86	$ 133,995.92
HENDERSON	$3,975.28	$3,216.00	$1,660.00	$6,343.00	$117,167.92	$16,512.00	$396.00	$14,472.00	$ 163,742.20	$2,218.23	$ 165,960.43
HERTFORD	$3,253.68	$816.00	$330.00	$1,100.00	$41,217.95	$4,448.00	$0.00	$7,680.00	$ 58,845.63	$0.00	$ 58,845.63
HOKE	$2,342.06	$896.00	$550.00	$3,472.79	$36,130.75	$4,624.00	$0.00	$9,144.00	$ 57,159.60	$229.82	$ 57,389.42
HYDE	$648.01	$224.00	$60.00	$470.00	$10,091.46	$1,408.00	$0.00	$1,056.00	$ 13,957.47	$91.27	$ 14,048.74
IREDELL	$8,220.53	$7,248.00	$2,090.00	$7,795.57	$197,879.57	$29,443.00	$0.00	$35,856.00	$ 288,532.67	$2,496.26	$ 291,028.93
JACKSON	$1,710.43	$1,504.00	$340.00	$1,670.00	$53,220.65	$5,968.00	$168.00	$4,116.00	$ 68,697.08	$407.93	$ 69,105.01
JOHNSTON	$3,362.00	$7,194.00	$2,370.00	$5,037.18	$249,710.00	$31,724.00	$1,776.00	$28,074.00	$ 329,247.18	$1,344.74	$ 330,591.92
JONES	$760.18	$352.00	$110.00	$280.00	$32,082.41	$2,016.00	$0.00	$1,800.00	$ 37,400.59	$0.00	$ 37,400.59
LEE	$3,456.51	$1,872.00	$840.00	$2,654.29	$72,086.85	$12,016.00	$0.00	$14,604.00	$ 107,529.65	$514.11	$ 108,043.76
LENOIR	$8,475.00	$3,584.00	$690.00	$2,240.00	$120,590.50	$12,448.00	$12.00	$29,532.00	$ 177,571.50	$294.34	$ 177,865.84
LINCOLN	$6,332.00	$3,312.00	$950.00	$1,830.00	$65,037.38	$15,136.00	$0.00	$11,376.00	$ 103,973.38	$686.86	$ 104,660.24
MACON	$3,526.38	$1,648.00	$550.00	$1,950.25	$53,240.18	$5,472.00	$0.00	$3,780.00	$ 70,166.81	$292.36	$ 70,459.17
MADISION	$1,152.90	$912.00	$330.00	$753.00	$40,913.87	$3,168.00	$0.00	$1,272.00	$ 48,501.77	$157.28	$ 48,659.05
MARTIN	$2,396.63	$784.00	$300.00	$1,900.00	$58,899.66	$6,832.00	$0.00	$8,628.00	$ 79,740.29	$89.76	$ 79,830.05
MCDOWELL	$2,111.76	$1,152.00	$310.00	$1,506.67	$91,336.13	$6,512.00	$0.00	$6,732.00	$ 109,660.56	$737.39	$ 110,397.95
MECKLENBURG	$30,775.10	$54,880.00	$13,760.00	$21,330.00	$929,375.20	$209,360.00	$0.00	$515,220.00	$ 1,774,700.30	$210,013.42	$ 1,984,713.72
MITCHELL	$1,430.19	$368.00	$160.00	$1,202.48	$15,357.43	$3,328.00	$0.00	$2,436.00	$ 24,282.10	$0.00	$ 24,282.10
MONTGOMERY	$1,418.78	$880.00	$250.00	$1,440.00	$35,469.26	$6,090.00	$14,916.00	$3,864.00	$ 64,328.04	$469.14	$ 64,797.18
MOORE	$5,284.00	$3,680.00	$1,160.00	$5,150.25	$130,399.60	$14,288.00	$0.00	$12,996.00	$ 172,957.85	$29,642.69	$ 202,600.54
NASH	$6,168.50	$4,746.00	$920.00	$3,802.00	$91,802.60	$20,064.00	$312.00	$15,924.00	$ 143,739.10	$4,220.43	$ 147,959.53
NEW HANOVER	$8,662.72	$12,338.00	$5,178.93	$7,802.31	$254,977.19	$49,680.00	$0.00	$70,980.00	$ 409,619.15	$2,446.54	$ 412,065.69
NORTHHAMPTON	$2,557.12	$816.00	$340.00	$1,073.00	$37,272.75	$2,432.00	$0.00	$4,224.00	$ 48,714.87	$303.10	$ 49,017.97
ONSLOW	$14,884.46	$5,552.00	$2,732.00	$4,310.00	$230,769.97	$38,983.00	$7,716.00	$33,072.00	$ 338,019.43	$556.65	$ 338,576.08
ORANGE	$2,371.52	$3,968.00	$1,690.00	$4,771.50	$121,996.54	$29,850.00	$0.00	$20,676.00	$ 185,323.56	$592.00	$ 185,915.56
PAMLICO	$878.87	$512.00	$190.00	$520.00	$11,030.39	$2,336.00	$0.00	$2,208.00	$ 17,675.26	$145.64	$ 17,820.90
PASQUOTANK	$6,379.23	$1,664.00	$580.00	$1,726.00	$52,160.02	$9,532.00	$432.00	$14,904.00	$ 87,377.25	$239.42	$ 87,616.67
PENDER	$2,616.60	$2,448.00	$600.00	$1,498.00	$96,287.82	$8,832.00	$84.00	$7,512.00	$ 119,878.42	$260.64	$ 120,139.06
PERQUIMANS	$779.41	$512.00	$350.00	$833.00	$23,193.18	$1,952.00	$24.00	$2,148.00	$ 29,791.59	$215.33	$ 30,006.92
PERSON	$3,999.04	$1,136.00	$410.00	$1,330.00	$59,103.19	$6,480.00	$0.00	$7,728.00	$ 80,186.23	$0.00	$ 80,186.23
PITT	$8,189.50	$6,911.00	$2,560.00	$4,693.58	$222,557.35	$34,262.00	$0.00	$79,260.00	$ 358,433.43	$1,667.14	$ 360,100.57
POLK	$1,097.24	$640.00	$300.00	$1,180.00	$43,474.75	$2,320.00	$0.00	$1,956.00	$ 50,967.99	$0.00	$ 50,967.99
RANDOLPH	$5,335.41	$3,856.00	$1,450.00	$4,740.00	$203,945.94	$22,224.00	$1,260.00	$22,812.00	$ 265,623.35	$44,486.89	$ 310,110.24
RICHMOND	$6,370.60	$2,320.00	$950.00	$2,255.00	$66,436.00	$12,848.00	$12.00	$15,120.00	$ 106,311.60	$11,636.17	$ 117,947.77
ROBESON	$5,515.50	$8,624.00	$2,060.00	$4,470.00	$124,174.82	$25,968.00	$3,125.00	$28,284.00	$ 202,221.32	$3,849.23	$ 206,070.55
ROCKINGHAM	$8,705.00	$3,328.00	$990.00	$5,961.05	$119,127.00	$18,096.00	$348.00	$34,236.00	$ 190,791.05	$602.32	$ 191,393.37
ROWAN	$6,072.19	$6,064.00	$2,310.00	$7,861.22	$151,926.32	$27,926.00	$49,212.00	$32,868.00	$ 284,239.73	$16,387.37	$ 300,627.10
RUTHERFORD	$4,170.06	$2,432.00	$890.00	$3,452.25	$106,429.78	$11,328.00	$0.00	$20,004.00	$ 148,706.09	$8,861.74	$ 157,567.83
SAMPSON	$4,824.59	$3,072.00	$707.43	$3,107.08	$145,668.70	15,536.00	$1,836.00	$19,836.00	$ 194,587.80	$514.53	$ 195,102.33

Report includes facility fee interest for 2000-01 of $576,512.05.

COUNTY FACILITY FEES
2005-2006

COUNTY	Superior Court Criminal	Superior Court Civil	Superior Court Special Proceedings	Superior Court Estates	District Court Criminal	District Court Civil	Magistrate Criminal	Magistrate Civil	2005 - 2006 Total Facility Fees by County	2005 - 2006 Facility Fee Interest Earned by County	TOTAL FACILITY FEES COUNTY AND INTEREST
SCOTLAND	$4,955.68	$1,360.00	$540.00	$1,309.47	$55,235.31	$7,104.00	$0.00	$17,556.00	$ 88,060.46	$159.71	$ 88,220.17
STANLEY	$6,128.50	$1,417.00	$900.00	$3,698.50	$107,884.68	$22,848.00	$0.00	$11,580.00	$ 154,456.68	$11,343.03	$ 165,799.71
STOKES	$4,769.26	$1,424.00	$730.00	$2,050.00	$56,961.75	$7,376.00	$0.00	$5,592.00	$ 78,903.01	$198.60	$ 79,101.61
SURRY	$7,419.16	$2,448.00	$940.00	$3,120.00	$111,222.52	$12,080.00	$2,772.00	$12,840.00	$ 152,841.68	$375.38	$ 153,217.06
SWAIN	$1,225.40	$560.00	$170.00	$310.00	$26,933.47	$2,704.00	$0.00	$1,284.00	$ 33,186.87	$222.33	$ 33,409.20
TRANSYLVANIA	$1,925.00	$1,072.00	$930.00	$1,181.05	$40,658.00	$4,816.00	$0.00	$2,532.00	$ 53,114.05	$0.00	$ 53,114.05
TYRRELL	$1,069.45	$96.00	$40.00	$120.00	$40,902.25	$800.00	$0.00	$900.00	$ 43,927.70	$73.08	$ 44,000.78
UNION	$14,245.27	$7,488.00	$1,990.00	$4,036.65	$187,414.00	$22,192.00	$1,560.00	$30,192.00	$ 269,117.92	$1,212.20	$ 270,330.12
VANCE	$5,914.00	$2,032.00	$430.00	$2,310.00	$100,275.00	$9,008.00	$888.00	$32,016.00	$ 152,873.00	$6,368.34	$ 159,241.34
WAKE	$16,106.88	$44,268.00	$12,170.00	$16,736.77	$1,165,346.63	$177,536.00	$18.00	$278,356.00	$ 1,710,538.28	$10,029.83	$ 1,720,568.11
WARREN	$1,782.00	$1,232.00	$250.00	$2,935.00	$49,610.00	$3,344.00	$0.00	$5,172.00	$ 64,325.00	$234.23	$ 64,559.23
WASHINGTON	$1,493.61	$480.00	$230.00	$645.00	$31,812.54	$3,024.00	$0.00	$6,000.00	$ 43,685.15	$156.42	$ 43,841.57
WATAUGA	$5,332.72	$2,288.00	$430.00	$28,819.19	$131,623.05	$7,574.58	$60.00	$6,879.09	$ 183,006.63	$961.08	$ 183,967.71
WAYNE	$12,215.14	$4,576.00	$2,090.00	$3,190.00	$153,462.05	$27,136.00	$0.00	$47,160.00	$ 249,829.19	$678.53	$ 250,507.72
WILKES	$3,788.25	$2,288.00	$1,170.00	$2,810.00	$104,400.90	$14,244.00	$0.00	$16,230.00	$ 144,931.15	$577.68	$ 145,508.83
WILSON	$6,639.52	$5,200.00	$961.05	$2,471.05	$114,909.82	$19,248.00	$0.00	$60,216.00	$ 209,645.44	$818.75	$ 210,464.19
YADKIN	$1,341.94	$848.00	$430.00	$1,900.00	$67,974.15	$7,840.00	$108.00	$4,620.00	$ 85,062.09	$499.62	$ 85,561.71
YANCEY	$577.66	$400.00	$250.00	$820.00	$15,843.26	$2,832.00	$0.00	$2,064.00	$ 22,786.92	$260.77	$ 23,047.69
SUBTOTAL	**$ 553,387.54**	**$ 429,019.00**	**$ 139,539.20**	**$ 368,592.50**	**$ 12,331,535.62**	**$ 1,947,154.32**	**$ 139,023.00**	**$ 3,028,235.09**	**$ 18,936,486.27**	**$ 662,018.49**	**$ 19,598,504.76**

Report includes facility fee interest for 2000-01 of $576,512.05.

Institute for Emerging Issues

Principles for State and Local Spending

Dr. Roland Stephen
December 19, 2006

NC STATE UNIVERSITY

research ideas debate action leadership

NC STATE UNIVERSITY

Institute for Emerging Issues

Outline of the presentation:

- Characteristics of a Budget
- Spending Principles
- Intergovernmental Transfers
- Examples
- Concluding Thoughts

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Characteristics of a Public Budget

- Comprehensive
- Unified
- Transparent
- Realistic

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Spending Principles

Institute for Emerging Issues

Efficiency: Spend at the lowest level of government, subject to limitations imposed by minimum efficient scale and spillovers.

Equity: Spend at higher level of government in order to ensure access to the law, and sufficient provision of health, education and other services.

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Principles of Intergovernmental Transfers

Institute for Emerging Issues

Transparency: Formulas governing the distribution of funds should be transparent and consistent.

Responsibility: There should be a match between responsibility and revenues at each level of government. No unfunded mandates and no unmandated funding.

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Principles in Practice

Institute for Emerging Issues

All these principles are not easily reconciled, Spending often looks like a layer cake:

- Multiple objectives
- Multiple levels of authority
- Multiple sources of funding (including state collected local revenues).

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Utilities

Institute for Emerging Issues

Local responsibility and local funds BUT:

- Small municipalities below minimum efficient scale.
- State funds lack mandate to consolidate.

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Roads

Institute for Emerging Issues

Combined state and municipal responsibility BUT:

- State funding is redistributive.
- State transfers based on a confusing formula.
- Municipalities lack responsibility or revenues to meet regional needs.

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K-12 Education

Institute for Emerging Issues

Divided state and county responsibility for funding, school boards as agents:

- State funding no longer meets equity standard.
- Counties struggle with building and/or supporting schools from property tax.
- School districts below or above efficient scale.
- Unfunded mandates.

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Health and Human Services

Institute for Emerging Issues

Divided state and county responsibility for funding, county as agents:

- Significant local funding of a redistributive program, Medicaid.
- Significant local administrative discretion.

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Justice and Public Safety

Institute for Emerging Issues

Divided state and county responsibility for funding operations and buildings:

- Significant equity considerations.
- Complicated mix leading to unfunded responsibilities.

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Justice and Public Safety

Institute for Emerging Issues

Divided state and county responsibility for funding operations and buildings:

- Significant equity considerations.
- Complicated mix leading to unfunded responsibilities.

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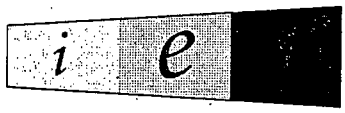
Concluding thoughts

Institute for Emerging Issues

- An appropriate level of government may require institutional change.
- Matching responsibility with revenues may increase program legitimacy.
- Clarity about redistributive needs will help determine the division of responsibilities

www.emerginguznes.org



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research idea debate action leadership

State and Local Fiscal Modernization Study Commission
12-19-06

Subcommittees

Income Tax Modernization

- Individual Income Tax
- Corporate Income Tax
- Flow-through entities
- Estate and gift taxes

Chair: Keith Davis
~~Mike Ruffin~~ Keith Crisco
John Medlin
Wilhelmenia Rembert
Norris Tolson
Cochair Oversight: Senator Hoyle
Staff Responsibility: Dan Schisler

Sales and Excise Tax Modernization

- Sales and Use Taxes
- State Excise Taxes
- State Privilege License Taxes

Chair: Tom Ross
Senator Pete Brunstetter
Linda Jones
Randall Fraser
Cochair Oversight: Rep. Carney and Dan Gerlach
Staff Responsibility: Ben Russo

Local Tax Modernization

- Property taxes
- Local option sales taxes
- Impact fees
- Occupancy fees
- Real estate transfer taxes

Chair: Rusty Harris
Senator Dan Clodfelter
Joe Carpenter
Terry Garrison
Sue Cole
Cochair Oversight: Rep. Carney
Staff Responsibility: Mike Walden

Infrastructure Responsibilities and Funding DeAnne

- Water and sewer
- Transportation
- Schools
- Courts

Chair: John Atkins
Rep. Linda Coleman
Allen Joines
Gwynn Swinson
~~Keith Crisco~~ Mike Ruffin
Cochair Oversight: Dan Gerlach
Staff Responsibility: Kara Millonzi

Program Responsibilities and Funding

- Health care services and Medicaid
- Social services
- Law enforcement
- Education
- Elections

Chair: Brad Wilson
Rep. Rick Glazier
Beth Ward
Kitty Barnes
John Stevens
Cochair Oversight: Rep. Barnhart and Senator Rand
Staff Responsibility: Karl Smith

State and Local Fiscal Modernization Study Commission

Program Responsibilities and Funding Subcommittee Charge

Charge

1. Determine whether the division of responsibility between state and local government for providing services including but not limited to health care services and Medicaid, social services, law enforcement services, education services and elections is appropriate.
2. Review the following program responsibilities and determine whether any changes are needed to align responsibilities in accordance with the general principles set out below:
    - health care services and Medicaid
    - instruction and current expenses related to K-12 education
    - judicial and other court personnel and corrections programs
    - confinement of persons convicted of crimes
    - social service programs
    - providing for elections

Principles of State and Local Government Spending

1. Efficiency. – Needs should be assessed and provided at the lowest possible level of government consistent with economies of scale and other efficiency concerns.
2. Appropriate Control. –Local functions should be paid for by locally controlled and collected revenue sources. State functions and state mandated functions should be paid for by state controlled and collected revenue sources.
3. Transparency. – Funding formulas should be driven by need or other factors closely associated with the provision of the service.
4. Equity. – Every citizen in North Carolina should be assured of receiving uniform and sufficient opportunities for essential services.

Impact of Suggested Changes

Determine the fiscal impact of suggested changes at the municipal and county level. This subcommittee should work closely with the local tax modernization subcommittee in examining the ability of local governments in North Carolina to pay for the services required by their citizens.

State and Local Fiscal Modernization Study Commission

Infrastructure Responsibilities and Funding Subcommittee Charge

Charge

1. Determine whether the division of responsibility between state and local government for providing infrastructure needs including but not limited to water and sewer, roads and other transportation needs, schools and courts is appropriate.
2. Review the following infrastructure spending areas and determine whether any changes are needed to align responsibilities in accordance with the general principles set out below:
    - water and sewer services
    - road construction and maintenance
    - other transportation costs
    - construction of school buildings
    - construction of court buildings, jails and other correction facilities
    - storm water management

Principles of State and Local Government Spending

1. Efficiency. – Needs should be assessed and provided at the lowest possible level of government consistent with economies of scale and other efficiency concerns.
2. Appropriate Control. –Local functions should be paid for by locally controlled and collected revenue sources. State functions and state mandated functions should be paid for by state controlled and collected revenue sources.
3. Transparency. – Funding formulas should be driven by need or other factors closely associated with the provision of the service.
4. Equity. – Every citizen in North Carolina should be assured of receiving uniform and sufficient opportunities for essential services.

Impact of Suggested Changes

Determine the fiscal impact of suggested changes at the municipal and county level. This subcommittee should work closely with the local tax modernization subcommittee in examining the ability of local governments in North Carolina to pay for the services required by their citizens.

State and Local Fiscal Modernization Study Commission

Income Tax Modernization Subcommittee

Charge

1. Determine whether the overall mix of revenue sources at the state level is appropriate.
2. Review the following taxes to determine whether any changes are needed to align the taxes in accordance with the general tax principles set out below:
   - Individual income tax
   - Corporate income tax
   - Estate and gift taxes.
3. Identify ways to broaden the tax base, lower tax rates, and eliminate deductions, exemptions, and credits, consistent with the tax principles.

Tax Principles

1. Equity. – A tax system should be equitable and fair resulting in similarly situated taxpayers being taxed similarly and similar transactions being taxed in the same manner.
2. Simplicity. –A tax system should be as simple as possible, thereby reducing compliance burdens on taxpayers and administrative burdens on government.
3. Sufficiency. – A tax system should provide the government with a sufficient and predictable source of revenue without having to resort to rate increases.
4. Efficiency. – A tax system should be efficient and not impede or reduce the productive capacity of the economy.

Impact of Suggested Changes

Determine the fiscal impact of suggested changes at both the state and local level. Changes within a subcommittee do not need to be revenue neutral.

State and Local Fiscal Modernization Study Commission

Sales and Excise Tax Modernization Subcommittee Charge

Charge

1. Determine whether the overall mix of revenue sources at the state level is appropriate.
2. Review the following taxes to determine whether any changes are needed to align the taxes in accordance with the general tax principles set out below:
   - sales and use tax
   - state excise taxes (including but not limited to tobacco product taxes, alcoholic beverage taxes, the motor fuels tax, and highway use tax)
   - state privilege license taxes.
3. Identify ways to broaden the tax base, lower tax rates, and eliminate special exemptions and rates consistent with the tax principles.

Tax Principles

1. Equity. – A tax system should be equitable and fair resulting in similarly situated taxpayers being taxed similarly and similar transactions being taxed in the same manner.
2. Simplicity. –A tax system should be as simple as possible, thereby reducing compliance burdens on taxpayers and administrative burdens on government.
3. Sufficiency. – A tax system should provide the government with a sufficient and predictable source of revenue without having to resort to rate increases.
4. Efficiency. – A tax system should be efficient and not impede or reduce the productive capacity of the economy.

Impact of Suggested Changes

Determine the fiscal impact of suggested changes at both the state and local level. Changes within a subcommittee do not need to be revenue neutral.

State and Local Fiscal Modernization Study Commission

Local Tax Modernization Subcommittee Charge

Charge

1. Determine whether the portfolio of taxes and fees and mix of revenue sources at the local level is appropriate.
2. Examine and evaluate local governments' ability to pay for services required by their citizens.
3. Review the following taxes and fees to determine whether any changes are needed to align the revenue sources in accordance with the general tax principles set out below:
    - sales taxes
    - property taxes
    - real estate transfer taxes
    - impact fees
    - vehicle use fees.
4. Identify ways to broaden the tax base, lower tax rates, and eliminate special exemptions and rates consistent with the tax principles.

Tax Principles

1. Equity. – A tax system should be equitable and fair resulting in similarly situated taxpayers being taxed similarly and similar transactions being taxed in the same manner.
2. Simplicity. –A tax system should be as simple as possible, thereby reducing compliance burdens on taxpayers and administrative burdens on government.
3. Sufficiency. – A tax system should provide the government with a sufficient and predictable source of revenue without having to resort to rate increases.
4. Efficiency. – A tax system should be efficient and not impede or reduce the productive capacity of the economy.

Impact of Suggested Changes

Determine the fiscal impact of suggested changes at the municipal and county level. Changes within a subcommittee do not need to be revenue neutral.

STATE AND LOCAL FISCAL MODERNIZATION STUDY COMMISSION

Monday, March 12, 2007
Room 544, Legislative Office Building
1:00 p.m.

I. Opening Remarks and Approval of Minutes

II. Income Tax Subcommittee Recommendations
Keith Davis

III. Sales Tax Subcommittee Recommendations
Tom Ross

IV. Local Tax Subcommittee Recommendations
Rusty Harris

Break

V. Infrastructure Subcommittee Recommendations
John Atkins

VI. Program Responsibilities Recommendations
Brad Wilson

VII. Summary of Recommendations
Roby Sawyers
Karl Smith

VIII. Open Discussion

V. Adjournment
Next Meeting: Monday, April 2, 1:00 p.m.

VISITOR REGISTRATION SHEET

State & Local Fiscal Modernization — March 12, 2007

Name of Committee — **Date**

VISITORS: PLEASE SIGN IN BELOW AND RETURN TO DeANNE MANGUM

NAME	FIRM OR AGENCY AND ADDRESS
Susan Harrison	WCPSS
June M. Kimmel	LWV-NC
Lucille Howard	LWV-NC
Jackie Burke	LWV-NC
Mary Klaus	League of Women Voters of NC
Meenal Majuria	NCML
Marc Finlayson	Highway 17 Association

VISITOR REGISTRATION SHEET

State & Local Fiscal Modernization — March 12, 2007

Name of Committee — **Date**

VISITORS: PLEASE SIGN IN BELOW AND RETURN TO DeANNE MANGUM

NAME	FIRM OR AGENCY AND ADDRESS
Jan Winters	Gaston County
Betsy Bailey	PENC
Sandy Sanders	WCSR
Amy McCorkey	SA
Bill O'Donnell	NCSBA
Cam Brawley	EY
Michael Haley	Dept. of Commerce
Will Culpepper	Moore & Van Allen

VISITOR REGISTRATION SHEET

State & Local Fiscal Modernization — March 12, 2007

Name of Committee — **Date**

VISITORS: PLEASE SIGN IN BELOW AND RETURN TO DeANNE MANGUM

NAME	FIRM OR AGENCY AND ADDRESS
Shellie Edge	Inst. for Emerging Issues
Michelle Rodeles	Inst. for Emerging Issues
Anita Brown-Graham	IEI
Diane Cherry	Institute for Emerging Issues
Carolyn S. Meiners	NCACC
Ed Wooten	NCACC
Judy Rhyne	NCACC
Rebecca Trudman	NCACC
Kara Millonzi	SOG
CHARLES WARD	PITT COUNTY COMMISSION

VISITOR REGISTRATION SHEET

State & Local Fiscal Modernization — March 12, 2007

Name of Committee — **Date**

VISITORS: PLEASE SIGN IN BELOW AND RETURN TO DeANNE MANGUM

NAME	FIRM OR AGENCY AND ADDRESS
Jay Stem	NC Aggregates Assoc.
Jessica Gray	VIF Program
Roland Stephens	IEI
Sara Warren	Wake Gov't
Cliff Umble	
Jennifer Willis	Wake Co Govt.
Mark Foster	NCDOT
Susan Cannon	NCDOT
Meg Gray	NC Budget & Tax Ctr
Elaine Mejia	NC Budget & Tax Ctr
DAVID MILES	COMMON SENSE FNDN

VISITOR REGISTRATION SHEET

State & Local Fiscal Modernization — March 12, 2007

Name of Committee — **Date**

VISITORS: PLEASE SIGN IN BELOW AND RETURN TO DeANNE MANGUM

NAME	FIRM OR AGENCY AND ADDRESS
Peter Harris	NC State Ports
Dennis Patterson	OSC
Bear Mills	NCMC/NCLM
Jenny Goode	NCGA
Mercidee Benton	OSBM
Celia Cox	OSBM
David Joyner	NCTA
Susan Coward	DOT
Guy Rim	NCCN
Jean Reaves	citizen Halifax County
Reid Hartzog	NCTA

(1)

Committee Name: **Income Tax Modernization Subcommittee**

Members: **Mr. Keith Davis, Chair**
Sen. David Hoyle, Co-chair
Mr. Randall Kaplan
Mr. John Medlin
Dr. Wilhelmenia Rembert
The Honorable E. Norris Tolson

Staff: **Ms. Cindy Avrette, Staff Attorney**
Ms. Sabra Faires, Senate Tax Counsel
Ms. Cindy Garrison, Committee Clerk
Dr. Roby Sawyers, NC State University
Dr. Dan Schisler, East Carolina University

Meetings: **12-19-06, 1-16-07, 1-22-07, 1-29-07, 2-15-07, 3-5-07**

I. Brief review of the subcommittee's charge

1. Determine whether the overall mix of revenue sources at the state level is appropriate.

2. Review the following taxes to determine whether any changes are needed to align the taxes in accordance with the general tax principles set out below:
   a. Individual income tax
   b. Corporate income and *franchise* tax
   c. Estate and gift taxes

3. Identify ways to broaden the tax base, lower tax rates, and eliminate deductions, exemptions, and credits, consistent with the tax principles.

4. Determine the fiscal impact of suggested changes at both the state and local level. Changes within a subcommittee do not need to be revenue neutral.

Tax Principles

i. Equity – A tax system should be equitable and fair resulting in similarly situated tax payers being taxed similarly and similar transactions being taxed in the same manner.

ii. Simplicity – A tax system should be as simple as possible, thereby reducing compliance burdens on taxpayers and administrative burdens on government.

Ms. Cindy Avrette, Staff Attorney, Research Division, North Carolina General Assembly – Ms. Avrette made a presentation with respect to North Carolina corporate income taxes. The presentation focused on the mechanics of the current tax system, its inherent weaknesses, prior attempts to repair its shortcomings, and possible solutions to include combined reporting.

Mr. Keith Davis, Senior Vice President and Director of State and Local Taxes, Bank of America Corporation – Mr. Davis discussed the advantages and disadvantages of combined reporting for corporate income tax purposes.

Mr. John Sharp, Chairman of the Texas Tax Reform Commission and former Texas Comptroller – Mr. Sharp discussed various aspects of Texas' recent tax reform (repeal of previous franchise tax and enactment of new alternative margins tax) to include "lessons learned".

Mr. Karey Barton, Tax Director of the Texas Tax Reform Commission and former Texas Director of Tax Policy – Mr. Barton also provided meaningful insights into Texas' recent tax reform.

Mr. Mike Hannah, Director, Multistate Tax Services, PricewaterhouseCoopers and former North Carolina Assistant Secretary of Revenue – Mr. Hannah provided the subcommittee with an overview of the current North Carolina corporation franchise tax and problems related thereto, information on prior legislative efforts to rectify some of the known problems and information on franchise taxes in other southeastern states.

Dr. Roby Sawyers, College of Management, North Carolina State University – Dr. Sawyers presented an overview of both the federal and North Carolina's current Estate and Gift tax system as well as what the future holds for these taxes based upon current law. Additionally, Dr. Sawyers provided the subcommittee with information on these tax systems in other states.

Dr. Dan Schisler, Chair, Department of Accounting, East Carolina University – Dr. Schisler discussed the advantages and disadvantages of using federal adjusted gross income ("AGI") as the tax base and a 5% flat tax rate for individual income tax purposes.

Mr. Karl Knapp, Director, Policy Analysis and Statistics Division, North Carolina Department of Revenue – Mr. Knapp provided the subcommittee with various individual income tax simulations. The simulations included various changes to the tax base, deductions, exemptions and tax rate.

Recommendation No. 5 – *Reduce the corporate income tax rate to a rate that is competitive with other southeastern states.* Other southeastern states have tax rates ranging from 5% to 6.5% and therefore, the subcommittee recommends that the state's rate be reduced to approximately 5.5%. ~~Additionally, a progressive rate structure should be considered as a tool to assist small businesses and possibly to achieve simplicity (see Recommendation No. 6).~~

Recommendation No. 6 – *Conduct a comprehensive review of the corporate franchise tax in conjunction with Recommendation No. 4 in order to alleviate any possible compliance burdens as a result of two corporate tax reporting systems.* The subcommittee noted that if a combined reporting system was enacted for corporate income tax purposes, the state would then have two separate reporting systems applicable to corporate taxpayers (combined income and separate franchise). This could promote significant compliance burdens on corporate taxpayers and the Department of Revenue and consequently, the corporate franchise tax needs further review in conjunction with Recommendation No. 4. ~~Consequently, repeal of the corporate franchise tax should be considered. The replacement of the current franchise tax revenues could be achieved with a progressive corporate income tax rate structure (see Recommendation No. 5). Repeal of the corporate franchise tax would promote simplicity, avoid possible compliance burdens noted above and possibly provide a competitive advantage over other southeastern states (the subcommittee noted that generally southeastern states impose a corporate franchise *and* income tax).~~

Recommendation No. 7 – *Repeal the existing Estate and Gift Tax.* The subcommittee noted that North Carolina was only one of four states to impose a gift tax and that the revenues collected there from has historically been extremely small. Additionally, the subcommittee noted that North Carolina is one of only nineteen states who have an estate tax. Of the southeastern states, only North Carolina and Virginia have an estate tax (Virginia's is set to expire in 2007) which makes the state less competitive for retirees. The subcommittee recommends a repeal of both the estate and gift tax systems in order to become more competitive and to simplify the state's taxing system.

Recommendation No. 8 – *Reduce the state's reliance on the individual income tax.* The subcommittee noted that North Carolina relies more heavily on the individual income tax revenues than most other states. An income tax is generally viewed as being less stable than consumption-based taxes and therefore, less reliance thereto would provide a more predictable source of revenue for the state.

Committee Name: **Local Tax Modernization Subcommittee**

Members:
Mr. Rusty Harris: Chairman
Rep. Becky Carney: Oversight Co-Chair
Sen. Dan Clodfelter
Mr. Joe Carpenter
Mr. Keith Criscoe
Mr. Terry Garrison

Meetings:
December 19, 2006
January 17, 2007
January 29, 2007
February 19, 2007

I. Brief review of the subcommittee's charge

Our charge:

1. Determine whether the portfolio of taxes and fees and mix of revenue sources at the local level is appropriate.
2. Examine and evaluate local governments' ability to pay for services required by their citizens.
3. Review the following taxes and fees to determine whether any changes are needed to align the revenue sources in accordance with the general tax principles set out below:
    a. Sales taxes
    b. Property taxes
    c. Real estate transfer taxes
    d. Impact fees
    e. Vehicle use fees.
4. Identify ways to broaden the tax base, lower tax rates, and eliminate special exemptions and rates consistent with the tax principles.

II. Issues dealt with over the last two months

1. Assessing the future needs of local governments. We primarily looked at needs associated with Education (current & capital), Medicaid, and Public Safety.
2. Based on revenue growth projections for local governments, we evaluated local governments' ability to pay for future needs
3. Examining revenue options available to local governments.

Recommendations:

Local governments need greater flexibility with taxing options in order to meet their needs going forward. A menu of taxes and fees should be available to local governments and should be consistent across the state. The menu should include, but not be limited to, options for sales taxes, real estate transfer taxes, impact fees, and vehicle use taxes. Additionally, should local governments be given the opportunity to fund road construction projects locally, a revenue sharing option for the gasoline tax should be considered. The legislature should set broad parameters for the appropriate use of these new options and identify an entity, such as the Local Government Committee, to provide oversight to local governments.

The state should also provide greater flexibility for the use of local tax revenues by lifting some mandates that earmark revenues.

2. Examine and evaluate local governments' ability to pay for services required by their citizens.

   Since the primary source of revenue for local governments is property tax, to a great extent, local governments' ability to pay for services required by their citizens is determined by the property values in their jurisdictions. Property values vary greatly across the state; therefore the revenue stream from property values varies greatly. Even with high property tax rates, low real estate wealth counties struggle today to meet the needs of their citizens, in part because of the disproportionately high Medicaid expenses in those areas. Additionally, for most counties the rate of growth of locally funded education expenses (both current expenses and capital expenses) and Medicaid expenses far exceed the rate of growth of property tax and sales tax revenue. Based on information presented to the subcommittee, the growth in local sales and property tax revenues over the next five years falls short of projected increases in Medicaid and education expenses by $2.0-$2.5 billion, and up to $3.5 billion if increased public safety expenses are included. Therefore, local governments already struggling to meet the needs of their citizens will find it even more difficult in the future, and more local governments that are currently able to meet their needs will be unable to do so in the future.

Property Taxes

Property taxes provide a relatively steady revenue stream and thus are an important part of the tax structure Property tax rates vary greatly between counties because of the variation in value of the underlying property. The result is a perception of inequity because of the wide variation in rates from county to county; however, the variation in taxes as a percent of income doesn't vary as much. In areas of high property value appreciation, property taxes put a hardship on fixed income residents, which is an issue that can be addressed. Additionally, exemptions from property taxes for industries can be a source of inequity.

Recommendations:

Consideration should be given to affording local governments with additional options related to property taxes:
Tax deferral for elderly or fixed income residents – this would allow the counties to place a lien on property in lieu of tax collections. The tax collection would take place when the property is sold. Income eligibility should be used as criteria for tax deferral.
Annual indexed revaluation – currently counties may revalue property every year, however, revaluation is costly and is typically done on a cycle ranging between four and eight years. Annual indexing would help local governments cost effectively recognize the true market value of new growth and, therefore, allow new growth to better contribute toward the costs of new infrastructure. Local governments that choose to use annual indexing should be required to perform property assessments a maximum of every four years.

Additionally, property tax exemptions should be reviewed to ensure the proper balance of maintaining a "pro business" climate with the equity issues of everyone paying their fair share.

Real Estate Transfer Taxes

Real estate transfer taxes are a version of a "sales tax" on real estate and are used as an alternative to higher property tax rates. Many states use real estate transfer taxes as a source of tax revenue. Given the wide range of value on real estate transactions, most states limit real estate transfer taxes to 1% or

services. For example, regional court systems and regional school districts could more efficiently serve the citizens than we do today.

Committee Name:

Infrastructure Responsibilities and Funding Subcommittee

Members:

John Atkins, III (Chair)
Dan Gerlach (Co-chair Oversight)
Rep. Linda Coleman
Mayor Allen Joines
Mike Ruffin
Gwynn Swinson

Meetings:

December 19, 2006 (11:30a.m. – 12:30p.m.)
January 22, 2007 (9:30a.m. – 12:30p.m.)
February 12, 2007 (9:30a.m. – 11:00a.m.)
February 19, 2007 (10:00a.m. – 11:00a.m.)
February 26, 2007 (9:30a.m. – 11:15a.m.)
March 2, 2007 (9:30a.m. -

I. Brief review of the subcommittee's charge

The subcommittee's charge is to examine the infrastructure needs of the State and local governments, including, but not limited to water and sewer, roads and other transportation needs, schools, and courts and determine: (1) whether the division of responsibilities between the State and local governments is appropriate; (2) whether any changes are needed to align responsibilities for infrastructure in accordance with the general principles of efficiency, appropriate control, transparency, and equity; and (3) determine the fiscal impact of any suggested changes on the State and local governments.

II. Issues dealt with over the last two months

The subcommittee, in order to manage its workload, focused mainly on public school construction, transportation infrastructure and water, sewer and stormwater infrastructure as the three most important state-local areas of fiscal responsibility.

Kennon Briggs, Vice President, Division of Business and Finance, NC Community College System

- Mr. Briggs described the financing relationship between community colleges, counties and the State—whereby counties are required to match state funding dollar for dollar, but counties can receive credits for dollars spent on community colleges independent of State funding. He then detailed the projected budget requirements for 2007-09 for equipment, facilities and master facilities and advanced planning for the State Community College System. The requested funds total approximately $1.4 billion. The community colleges expect that counties will match the State funds provided for renovation and repair and new construction—approximately $1.2 billion. Mr. Briggs also discussed a current study by community colleges of what facilities and programs are needed to satisfy the new economic development needs of the State.

Water, Sewer & Stormwater Infrastructure Financing

Bill Holman, Visiting Senior Fellow, Nicholas Institute for Environmental Policy Solutions, Duke University

- Mr. Holman provided a brief overview of the NC State Water Infrastructure Commission and reviewed its recent recommendations to the Governor and members of the General Assembly on potential solutions to meet the State's water infrastructure funding needs. He cited a 2005 study of the State's infrastructure capital needs by the NC Rural Center, which estimated that approximately $16.6 billion is needed between 2005 and 2030 for water, sewer and stormwater infrastructure—to develop new treatment facilities and upgrade existing facilities, to improve operations and maintenance capacities, to provide needed technical assistance and training for owners and managers, and to adequately plan for sustainable water resources. $6.85 billion is needed in the first five years. He suggested that water systems across the state are struggling because of escalating construction cost overruns pushed by global forces such as increases in petroleum and material prices that affect the cost of water and wastewater pipe. Moreover, according to Mr. Holman, federal funding for infrastructure continues to decrease, and many North Carolina communities cannot afford to finance their infrastructure needs without public assistance due to small customer bases and their underlying economic conditions. For example, there are over 100 wastewater systems under some type of order from the State, either limiting or preventing additional connections to their systems because they fail to meet regulatory standards. The numbers are similar for water systems. Among the recommendations of the Water Infrastructure Commission are that the State: (1) establish new, stable funding for water, wastewater and stormwater infrastructure of at least $100 million per year; (2) authorize a referendum for the passage of a $1 billion Clean Water Bond to replace the (now depleted) 1998 Clean Water Bond proceeds; (3) provide $50 million in State appropriation to address immediate and critical water infrastructure needs this year; (4) establish

local level, he suggests that the most important practices include realistic capital improvement plans, cash flow planning, leak detection, planned and periodic rate increases, and use of capital reserve funds. Finally, Mr. Hughes briefly talked about stormwater infrastructure financing. He noted that as local governments' responsibilities for stormwater management have increased over the past several years, local governments are beginning to assess user fees to cover the costs. A significant amount of the revenue raised from the user fees is being used to cover the costs of existing services; thus, increases in available funds for capital purposes have been relatively modest. There also currently are limited sources of State and federal funding for stormwater capital projects.

Transportation Infrastructure Financing

Mark Foster, Chief Financial Officer, N.C. Department of Transportation

- Mr. Foster provided some general background information on North Carolina's transportation infrastructure and infrastructure financing, including the division of responsibilities for roads between the State and local governments and the breakdown of funding sources and funding uses at the State and local levels. Mr. Foster also provided comparative transportation infrastructure and revenue data for the five other southeastern states and noted that, with the exception of South Carolina, North Carolina consumers pay the least amount of combined annual taxes and fees to fund transportation infrastructure. He provided information on projected growth in North Carolina over the next twenty-five years and its impact on transportation infrastructure funding needs—detailing an estimated $65 billion funding gap for State infrastructure needs by 2030. Mr. Foster attributed the projected funding gap to construction cost escalation, delays in the completion of projects due to cash shortages, decreasing federal aid, and dramatic population increases. He also cited the failure of traditional revenue sources to keep pace—particularly the gas tax, which has not kept up with CPI and construction inflation, and the revenue from which also has decreased because of the increased fuel efficiency of vehicles. Finally, Mr. Foster stated that transportation infrastructure in North Carolina requires immediate attention to address local, state and global economic needs. At a minimum, he suggested that funding needs to keep pace with the State's growth and construction inflation. He proposed exploring new funding options and leveraging incremental new funding to accelerate project delivery.

Beau Mills, Director of Intergovernmental Relations for the NC Metropolitan Coalition, North Carolina League of Municipalities

- Mr. Mills presented information on the transportation funding difficulties faced by municipalities. According to Mr. Mills, the municipal road system in North Carolina is over 20,000 miles and is growing eleven times faster than the state road system. Transportation costs comprise a large portion of most municipal budgets. In fiscal year 2004-05, total municipal expenditures on transportation

.004 percent. Counties with high debt burdens are generally rapidly growing urban and suburban areas. Mr. Holloman also reviewed the State debt capacity model for determining additional debt capacity each year.

State Facilities' Needs

- Dan Gerlach provided the subcommittee members with a written summary of the State's six-year capital improvements needs schedule. The total repair and renovations requests for education, general government, health and human services, justice and public safety and natural and economic resources for the six year period from 2007-2013 is approximately $1.3 billion. The total capital improvement requests is approximately $8.8 billion, and the total new construction requests is approximately $7.5 billion.

Global Summaries

- High quality infrastructure should be viewed as an investment, not a cost, for the State and local governments. Wise investments in infrastructure are necessary for North Carolina to grow jobs and investment across the State.

- While tradition has it that the State is responsible for the vast majority of the road systems and the local governments are responsible for capital spending for public schools, community colleges, and water & sewer infrastructure, there has been considerable ***blending of the state-local relationship*** in these areas.

- Infrastructure costs have been skyrocketing due to the increased demands of a growing populace and ***global cost increases in building materials***. There is no way to avoid these realities.

- Raw numbers of need that appear to be unattainable should not stop the Commission from addressing the needs.

- State and local governments have the option of taking on more debt to finance needed improvements. However, there are ***limits to the amount of debt*** that can be reasonably assumed. The Governor's proposed debt package includes $250 million in support for water & sewer, but no proposal for public school construction due to the debt affordability constraints. State debt capacity for highway funds is $375 million.

- The hierarchy of infrastructure funding needs is as follows: (1) transportation infrastructure, estimated at $65 billion over 25 years (or an average of $13 billion over 5 years); (2) school construction, estimated at $9.8 billion over 5 years; and (3) water, sewer and stormwater infrastructure, estimated at $6.85 billion over 5 years.

IV. Specific recommendations (with a discussion of the reasoning and explanation for those recommendations)

The subcommittee has both global recommendations based on the general principles outlined in the subcommittee's charge and specific recommendations in the three areas of focus to date.

Recommendations Based on General Principles

Efficiency and Prioritization

Determining the best practices to keep costs down requires discipline. The Subcommittee recommends that the General Assembly and relevant agencies consider the following:

- DPI and the General Assembly should provide guidance and incentives for local school districts that furnish cost-efficient space, both for capital construction and for operating costs.
- DPI should examine the use of public-private partnerships as options for local school districts to complete construction more quickly and efficiently.
- DENR and relevant parties should adopt the Water 2030 recommendation to promote better operation and management of water and sewer systems. Incentives should also be provided to encourage regionalization, planning, and eco-friendly practices.
- State resources for water and sewer need to be focused on those communities that have the most significant economic or environmental challenges first.
- DOT should engage professional advice on how to reduce the time to construct new roads and ensure that there are accountability measures for time to completion and quality of work.
- DOT and DENR should identify ways to complete projects more quickly and allow contractors to get permits in as timely a manner as possible.
- DOT should take advantage of permitting flexibility and financing assistance from the federal government.
- DOT priorities should be for uses of money that serve statewide tier or regional needs in order to reduce congestion and increase mobility.
- DOT should set clear performance standards and a plan to meet them.

Appropriate Control

Local Flexibility

The Subcommittee concurs with the conclusion of the Local Government Financing Subcommittee that all local governments need alternatives to the property tax and existing sales taxes to support local infrastructure, at local option. To that end, the subcommittee recommends the following:

- Any shift from local governments to state government for funding responsibility must include a swap of revenue authority or changes in budget trends to increase capacity to handle that shift. Any shift in responsibility should take into consideration the consequences on all types of governments to avoid any unintended consequences.
- Any shift from state government to local governments for funding responsibility must include a transfer of revenue authority or changes in budget trends to increase capacity to handle that shift. Any shift in responsibility should take into consideration the consequences on all types of governments to avoid any unintended consequences.

Specific Recommendations

The subcommittee makes the following recommendations with respect to the three areas of focus to date:

Public School Construction

- The State should continue to provide a share of the corporate income tax and education lottery for school construction projects.
- Counties should be authorized to increase the deed stamp tax at local option to fund infrastructure needs driven by growth, including public schools.

Water, Sewer and Stormwater Infrastructure

- The State should issue bonds to replace the now depleted 1998 Clean Water Bonds. (The Governor's recommendation is for $250 million.)
    - The State bonds should be allocated to local utilities that have the greatest needs first (*e.g.* utilities that are under moratorium or other special order).
    - The State should also use bond proceed revenue to provide incentives to local utilities to regionalize or otherwise provide more cost effective services.
- Local governments should assess user rates to cover fully both capital and operational costs.

Transportation Infrastructure

- In the short-term, the State should consider increasing the sales tax on vehicles and weight-based registration fees.
- Increased revenue sources for transportation infrastructure may be considered to repay debt service on existing transportation bonds along with existing highway debt capacity.
- Over the long-term, the State should consider reducing reliance on the gas tax and providing alternative proxies to road use that would lead to additional resources for transportation infrastructure, such as a vehicle mileage tax.

Report to the State and Local Fiscal Modernization Commission:

Sales and Excise Tax Modernization Subcommittee

March 12, 2007

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Meetings:

12:00 noon – 1:30 pm, December 19, 2006
10:00 am – 1:10 pm, January 16, 2007
1:00 pm – 3:25 pm, February 19, 2007
12:00 noon – 2:15 pm, March 1, 2007

I. Subcommittee Charge

1. Determine appropriateness of the overall mix of revenue sources at the state level.
2. Determine whether changes in sales and use taxes, state excise taxes, and privilege license taxes are needed to align these taxes with general tax principles
3. Identify ways to broaden the sales tax base, lower tax rates, and eliminate special exemptions and rates, in order to align taxes with general tax principles.

II. Issues:

1. The subcommittee compared the proportions of state and local tax revenue collected from sales taxes in different states. In 2004, the proportion of North Carolina taxes

them.[3] However, exempting some services can open the door for taxed service providers to argue their services also should be exempt. Therefore, political pressure to expand exemptions, and narrow the tax base, could be powerful, and are unlikely to observe tax principles. This point received a great deal of emphasis. Nevertheless, a concern was expressed that taxing medical services (E.G., dentists, doctors, nurses working outside hospitals, and medical labs) may not be viable or advisable.[4] On the other hand, rapid growth in medical services has contributed to sales tax base erosion. This is likely to continue, and could be worsened by retirement of the baby-boom generation. Excluding medical services narrows the base substantially. If equity is the reason for exempting medical services, an alternative would be financial support for medical spending for low income families. Excluding all medical services from sales taxation is an inefficient way to provide relief because it benefits many families who generally are not included in the group that needs relief. It may be best to tax all medical services, and target relief on poor families, as in Hawaii and New Mexico.

7. Karl Smith used the tax calculator to show how revenue growth and tax rates would be affected by the following revenue neutral changes in state and local sales tax structure:

a. broadening the sales tax base to include health services

b. broadening the sales tax base to include professional services

c. broadening the sales tax base to include entertainment

d. broadening the sales tax base to include food for home consumption

e. broadening the sales tax base to include all other exempted commodities

f. narrowing the sales tax base by excluding business-to-business transactions

g. broadening the sales tax base to include all other exempted commodities, all services, and food for home consumption

h. broadening the sales tax base to include all other exempted commodities, all services, food, but excluding business-to-business transactions

8. The committee compared state and local total tax revenues, and state and local sales tax rates. In 2004 North Carolina total tax revenue, as a proportion of personal income and in per capita terms, was less than the national average, but higher than in other mid-south states. The point was made that average tax rates, not marginal tax rates, probably are more important in location decisions. As well, comparing tax rates without comparing state services may not be informative, because the level of tax revenues tends to reflect citizens' demands for public services.[5]

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[3] Hawaii's General Excise Tax and New Mexico's Gross Receipts Tax (sales taxes by other names) are levied on each service that the Federation of Tax Administrators includes in the category 'professional services.' South Dakota's sales tax is levied on most professional services.

[4] Hawaii's General Excise Tax and New Mexico's Gross Receipts Tax are levied on all medical services. No state taxes hospital services.

[5] Note that this point is consistent with a focus on revenue neutral reform of tax structure.

estimates of tax rates that would result if these transactions were included, and the level of sales tax revenue was maintained at current levels. The Appendix also presents some rough approximations to the difference between the expected growth rate of revenue and the expected growth rate of personal income in North Carolina, during the next twenty-four years, under different conditions. For example, given the current sales tax base, sales tax revenue will tend to grow an average of about 1.3% less than personal income each year for the next few decades. This occurs because currently taxed commodities tend to grow at a slower rate than the rest of the economy, and is indicative of erosion in the sales tax base. The Appendix shows that if health services were added to the sales tax base, revenue would tend to grow about 0.5% less than personal income: that is, the sales tax base would erode by less if health services were added to the sales tax base.[8]

2. Andy Sabol, Director of the Sales and Use Tax Division of the Department of Revenue outlined requirements of the Streamlined Sales and Use Tax Agreement, and answered questions. North Carolina is in full compliance with SSUTA.

3. Sabra Faires discussed her February 2003 memo to Secretary Tolson of the Department of Revenue. The memo included recommendations in response to the 2002 Governor's Commission to Modernize State Finance.

a. Sabra said many changes have been made in the sales tax, in response to SSUTA. Some differential rates and caps have been repealed. A 1% rate on certain transactions was repealed: these transactions are now taxed by the privilege license tax.[9] However, most exemptions listed in Sabra's 2003 memo remain, and new ones have been added: for example, there now is a special rate for modular homes. A $1,500 exemption for funeral expenses has been repealed: now tangible personal property sold by funeral homes is taxable, but funeral services remain exempt.

b. A Sales Tax Holiday has been created. Studies show tax holidays do not increase sales; instead, some sales are shifted to the period of the tax holiday, to avoid taxation. Thus, net tax collections tend to decline. However, retailers tend to raise prices during tax holidays, so the main benefit appears to accrue to retailers rather than consumers.

c. Broadening of the sales tax may usefully be thought of as taking place in three steps:

i) extend the tax to currently exempt tangible personal property.

ii) extend the tax to currently excluded services that are related to the purchase of tangible personal property, or are provided with the repair or maintenance of real personal property (E.G., tax lawn mower service, not

[8] These illustrations are only rough approximations. Actual values will deviate from the estimates because of uncertainties in the model and unanticipated changes in the economy.

[9] These are coal, coke, and fuel oil used in manufacturing; manufacturing machinery and equipment; parts and accessories to manufacturing machinery; and manufacturing machinery purchased by contractors for use in the performance of contracts to construct manufacturing facilities.

income tax. This approach could also allow the State to consider eliminating the corporate income tax.

4. In light of these observations, the Subcommittee has agreed upon the following concepts:

a. North Carolina should broaden the sales tax base to include services, in a revenue neutral manner, and lower the sales tax rate. Base-broadening should take into consideration principles of equity, efficiency, and competitiveness, and should be accomplished in the simplest feasible manner consistent with these principles.

b. North Carolina should not exempt services from the sales tax base. The committee is mindful of difficulties in implementing this concept. Significant implementation issues, yet to be examined, must be addressed. A transition period may be required. Additional time is required to undertake this work

c. North Carolina should eliminate differential rates in the sales tax as well as sales tax exemptions. The committee supports elimination of the state food exemption, and the ½% local food exemption, but only under the condition that a mechanism is provided that would relieve lower income households from any additional tax burden.

d. North Carolina should move all excise taxes to an ad valorem methodology. In making this change the state may wish to consider not including the excise tax in the price of goods to which any sales tax is applied.

e. North Carolina should consider including privilege taxes as sales/use taxes or eliminate them all together since there are so few.

V. Issues yet to be reviewed and plan going forward:

1. The Subcommittee has tentatively agreed on the concept that North Carolina's general sales and use tax should be broadened to cover services, in a revenue neutral manner, so that the sales tax rate can be reduced. However, the Subcommittee is not yet prepared to forward concepts or recommendations about which types of services should be taxed, or how base broadening should be implemented.

2. The intangible nature of services tends to complicate implementation of a sales tax on services. Therefore, services are more difficult, than tangible goods, to tax. For example, sales taxes on accounting, financial and legal services can be difficult to source. Suppose a North Carolina law firm with offices in many states purchases accounting or financial services from a firm in Atlanta, to be used in all its law offices. It is not easy to determine where the services are performed or where they are used.

~~local govt~~

~~Consistent menu of taxes~~

Program Responsibilities Subcommittee

Members
Mr. Brad Wilson - Chair
Sen. Tony Rand – Co-Chair
Ms. Kitty Barnes
Rep. Rick Glazier
Mr. John Stevens
Mrs. Beth B. Ward

Staff
Karl Smith
Vickie Spears

Meetings: 12-19-06; 1-28-07; 2-26-07

***Charge**: This subcommittee was charged with examining the division of responsibility between state and local government for providing services including but not limited to health care services and Medicaid, social services, law enforcement services, education services and elections and recommend any necessary changes in those responsibilities.*

Issues

- State and County Responsibilities for Medicaid
- Timeline for state takeover of Medicaid
- Cost saving measures for Medicaid
- The effect of Medicaid changes on access
- K12 and Community College Funding
- Alignment of revenues and responsibilities

Speakers

Carol Shaw – provided an extensive overview of Medicaid funding and Disproportionate Share

Rebecca Troutman – provided information and guidance on Medicaid costs

Introduction to Recommendations

North Carolina is currently the only state which requires its counties to pay a fixed percentage of all Medicaid expenditures. In addition, counties pay the full non-federal share of local Medicaid administrative costs, estimated at a county expense of $86 million in 2007-08. While Medicaid is administered at the county level, counties have

Medicaid Cost Controls

In the long term Medicaid costs are best controlled by the implementation of wellness practices on the part of the residents of North Carolina. The subcommittee recognizes that even modest amounts of increased exercise, weight loss and smoking cessation will lead to dramatic decreases in the long run costs associated with Medicaid.

The subcommittee therefore recommends that the following steps be taken towards development of a wellness strategy for North Carolina:

- Pilot programs be created or expanded in the following areas:
    - Both positive and negative incentives for undergoing a wellness evaluation and then adhering to the health guidelines based on that evaluation
    - Wellness and Fitness programs in schools
    - Community Care and Prescription Management programs to ensure that patients are properly following their treatment regimen
- Leveraging of existing programs for state employees and bridging them to Medicaid
- Screening for long term health issues at the county level when an individual first applies for Medicaid in a effort to determine which individuals are most in need of early care

In addition the subcommittee recommends:

- Pilot programs for Medicaid HMOs
- The collection and dissemination of best practices for health management among the 100 counties
- Exploration into additional fees for smoking
- Exploration into federal matching for out patient prisoner care.

Lastly, while the subcommittee recognizes that North Carolina has relatively high reimbursement rates when compared to neighboring states the subcommittee recommends that the state explore measures to improve results rather than limit reimbursements. To that end the subcommittee recommends:

- Leveraging and expanding pay for performance programs
- Linking benchmark care standards to be developed by the Governor's office to reimbursement rates

Other Programs

While the subcommittee did not have sufficient time to investigate all programs thoroughly it did identify several areas of concern and recommends further investigation into

- County funding of state responsibilities for school operating expenses for k-12

- State funding for continuing costs at Community Colleges
- The reduction in the number of school districts to no more than one per county and potentially less
- Resource sharing between counties for jails, courthouses and schools
- Reexamination of historical formulas for mental health funds
- Reexamination of formulas for transportation investments

In addition the subcommittee believes that the funding and authority for local elections officials be re-examined. Currently personal are employed by the county but report to state officials. The subcommittee recommends that either the official be put under the authority of county governments or the funding responsibility be transferred to the state.

Local Revenue Options

Lastly the committee recommends an expansion of the revenue options available to counties. Counties which have the resources and the desire to expand services should be allowed to levy the funds to do so.

As a basic principle any revenue source that is currently available to some counties should be available to all counties. This includes but is not limited to:

- Sales tax option for transit
- Occupancy tax
- Impact fees
- Land transfer fees
- Prepared food tax

little control over the program itself. This has created a disconnect between funding responsibility and authority.

Perhaps more significantly, ability to pay for Medicaid expenses differs widely between counties. Counties with slow growth and less economic development have a higher proportion of Medicaid enrollees and fewer resources with which to fund them. In three counties Medicaid expenditures exceed 30% of property tax revenue and in half Medicaid expenditure exceeds funding for school capital needs.

This situation is only likely to exacerbate in the coming years as Medicaid expenditures outstrip economic growth in general and dwarf economic growth in many rural counties.

Therefore, this committee recommends that the most pressing program responsibility need is for Medicaid expenditure to be transferred to the state. The committee also recommends that action should be taken to curb the overall growth of Medicaid costs and to obtain additional funding from Federal sources. In, addition the committee recommends that action be taken to align funding and authority in education and the administration of elections.

Medicaid Takeover

The subcommittee recommends that the state assume responsibility for the county share of Medicaid. As the state identifies the funding stream to assume the county share, it should immediately retain at its expense the cap on county Medicaid costs at the 2005-06 level and provide with its revenues additional targeted relief to those counties hardest hit by their Medicaid burden.

The subcommittee believes that this is critically important for several reasons:

- The current county share of Medicaid is a crippling responsibility in many counties, which crowds out efforts at education and economic development. Without investment in education and economic development there is little chance that these counties will be able to sustain and improve their quality of life and community opportunities.
- The costs for Medicaid are growing rapidly and each year more county budgets will become crippled by rising costs.
- Counties for which Medicaid is a relatively small expenditure are typically high growth counties that could use the relief of Medicaid to fund critical infrastructure needs

The subcommittee is aware that county Medicaid relief will impose increase costs on the state and recommends that the Full Committee adopt a funding source whose growth is commensurate with the growth in Medicaid expenditures. In addition the subcommittee recommends that the Full Committee adopt long range cost control measures described below.

APPENDIX

This appendix reports estimated tax rates that could result from including additional types of spending in North Carolina's sales tax base. The estimates are produced by the Institute of Emerging Issues' tax calculator. Also reported are very rough approximations of expected growth effects. The expected growth effects are derived from tax calculator estimates and are intended only as illustrations. They may be inaccurate due to uncertainty in the derivations and unanticipated changes in the economy.

I) Expected Growth and Tax Rates Given the Current Sales Tax Base:

Revenue Growth – Income Growth	Spending Taxed	State Rate needed for Current Revenue	Local Rate needed for Current Revenue
- 1.3%/year	**27%**	**4.25%**	**2.50%**

II) Expected Growth and Tax Rates if Additional Types of Spending are Included in the Tax Base (revenue constant at current levels):

Health services:

Revenue Growth – Income Growth	Spending Taxed	State Rate needed for Current Revenue	Local Rate needed for Current Revenue
- 0.5%/year	**35%**	**3.13%**	**2.00%**

Professional services:

Revenue Growth – Income Growth	Spending Taxed	State Rate needed for Current Revenue	Local Rate needed for Current Revenue
- 1.0%/year	**30%**	**3.75%**	**2.38%**

Entertainment services:

Revenue Growth – Income Growth	Spending Taxed	State Rate needed for Current Revenue	Local Rate needed for Current Revenue
- 1.0%/year	**32%**	**3.50%**	**2.13%**

Groceries:

Revenue Growth – Income Growth	Spending Taxed	State Rate needed for Current Revenue	Local Rate needed for Current Revenue
- 1.3%/year	**32%**	**3.50%**	**2.50%**

Construction/rental services:

Revenue Growth – Income Growth	Spending Taxed	State Rate needed for Current Revenue	Local Rate needed for Current Revenue
- 0.2%/year	**59%**	**1.88%**	**1.25%**

All other exemptions:

Revenue Growth – Income Growth	Spending Taxed	State Rate needed for Current Revenue	Local Rate needed for Current Revenue
- 0.8%/year	**46%**	**2.38%**	**1.50%**

All services, groceries, and all other exemptions:

Revenue Growth – Income Growth	Spending Taxed	State Rate needed for Current Revenue	Local Rate needed for Current Revenue
+ 0.2%/year	**99%**	**1.13%**	**0.88%**

All services, groceries, all other exemptions, excluding Business-to-Business Transactions:

Revenue Growth – Income Growth	Spending Taxed	State Rate needed for Current Revenue	Local Rate needed for Current Revenue
+ 0.2%/year	**61%**	**1.75%**	**1.25%**

3. Further, the Federation of Tax Administrators enumerates one-hundred and sixty-eight different services, under seven general headings.[12] Administrative, compliance, implementation, and situsing issues all may vary, depending on the particular service. For example, professional services are difficult to source. In contrast, many personal services, such as lawn service, are easy to locate. However, personal services often are provided by very small firms. It is unclear whether the revenue that would be produced by taxing such services will exceed administrative costs. In order to broaden the sales tax in a sound way, and in accord with general tax principles, each of these issues for each type of service will require detailed study.

4. For these reasons, much additional work is required before the Subcommittee can agree on specific recommendations, and plans for their implementation. It appears unlikely this work will be completed by the planned Commission meeting in April or even this spring.

[12] The general headings are: Admissions and Amusements; Business Services; Computer Services; Fabrication, Installation, and Repair; Personal Services; Professional Services; Utilities; and Other Services.

just the spark plug installed when a lawn mower is serviced).

iii) tax additional services.

d. Sales taxes on some services are more difficult to implement than others because it is tricky to determine the source of the service. For example, it is easy to determine the source of a lawn service: it is the customer's location. But what is the source of a will sent to a client's residence through the mail? Is it the lawyer's office, or the residence? Accounting, advertising, and legal services present the most difficult sourcing issues.

e. Exempting food is administratively difficult, because subtle distinctions must be made.

IV. Concepts Brought Forward for the Commission's Consideration:

1. This section describes concepts the Subcommittee has agreed to bring forward for consideration by the full Commission. A brief introduction provides the general rationale or the concepts.

2. North Carolina's sales tax is levied primarily on tangible goods. Since North Carolina introduced its general sales tax, spending has shifted from goods to services.[10] As a result, over time, the sales tax base tends to decline as a fraction of personal income and as a fraction of government services. This erosion of the sales tax base is likely to continue. Therefore, the sales tax does not satisfy the principle of sufficiency. The narrowing tax base requires higher tax rates, which are inefficient and uncompetitive. Because the sales tax is narrowly focused on personal property, it discriminates against manufacturing, and against households that rely disproportionately on goods (that is, poorer households), which is inequitable. Spending on services tends to be more stable than spending on tangible goods, so excluding services makes the sales tax base less stable over the business cycle. The food exemption makes matters worse: careful research has shown that exempting food makes the tax less stable.[11] Including food would increase sales tax stability. Broadening the sales tax base to include food (and compensating low income households for the food tax) and services probably is the only tax reform capable of improving sufficiency, equity, efficiency, and stability. However, some difficulties lie in administration and compliance.

3. If the sales tax base in broadened to include services, revenue held constant, this will enable North Carolina to enjoy a substantially lower sales tax rate and provide the opportunity for the State to better balance revenue among sales tax and the personal

[10] When the sales tax was introduced in 1932, about 68% of household consumption spending consisted in tangible personal property, with the remainder consisting of services. Spending on goods has gradually declined to about 41% of household consumption spending.

[11] Unlike food spending, spending on non-food manufactured goods, such as appliances and consumer electronics, varies substantially over the business cycle. Therefore, state sales tax bases that exclude food are less stabile, over the business cycle, than state sales tax bases that include food.

9. The committee discussed recent state tax reforms. Not many states have successfully extended sales taxes broadly to services. In 1987, Florida broadened its sales to many services, but the extension was repealed. At least one close observer of Florida's experience suggests the tax did not survive for political reasons. Nebraska broadened its sales tax to many services in 2002, and its attempt appears to have been successful.

10. The committee discussed North Carolina excise taxes. Excise taxes on wine, beer, and tobacco are levied per unit. The excise tax on gasoline is levied partly on a unit basis and partly on a percentage (ad valorem) basis. The excise tax on spirituous liquor is levied strictly in percentage terms. Real (that is, inflation-adjusted) tax collections from unit excise taxes are eroded by inflation, unless the General Assembly explicitly increases the per unit excise.[6] In contrast, the real value of both the sales tax and North Carolina excises levied in percent terms are automatically protected against inflation because the price of taxed commodities tends to rise with inflation.[7] The committee reached a consensus that a way should be found to prevent inflation-induced erosion in real tax collections.

11. The committee discussed the fact that beer, wine, spirituous liquor, and tobacco are taxed both by excises and by the general sales tax. For these commodities, North Carolina currently levies the general sales tax on the full retail sales price, which includes the excise tax (which is usually collected at the wholesale or distributor level). There was consensus that current practice should change: A mechanism for separating the excise tax from the retail sales price should be found, and the sales tax should be applied only on the latter.

12. Ten states apply both sales tax and excise tax on gasoline. The committee briefly discussed applying the general sales tax to motor fuel. Doing so would raise substantial revenue, and permit a substantial decrease in the sales tax rate. Sabra Faires, former Assistant Director, Department of Revenue, pointed out that it could be difficult to collect retail sales tax on gasoline because the incentive and the ability to avoid the tax would both be great. A sales tax on gasoline may be regressive, because lower income households probably spend a relatively high fraction of their incomes on gasoline. Also, a sales tax on gasoline could fall disproportionately heavily on rural households and businesses.

III. Speakers

1. At two meetings Karl Smith used the tax calculator to present estimates of sales tax revenue growth and tax rates. Karl demonstrated the effects of adding currently exempted or excluded sales transactions to the sales tax base. The Appendix presents

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[6] For example, if the inflation rate averages 2.5% per year, after ten years a fixed per unit excise tax declines by about 22% in real, inflation-adjusted, terms.

[7] Anna Mitchell, Assistant Director of the Department of Revenue's Sales and Use Tax Division, pointed out that there is no clear reason for the different tax treatment of sales and some excise taxes. Staff made the conjecture that a partial explanation may be historical: when the earliest excises were imposed, it was difficult to calculate commodity taxes in percentage terms. This no longer is the case.

collected by its sales tax (about 23.5%) is slightly less than the national average (about 24.2%), and three of the other five mid-southeast states.[1]

2. The committee compared the number of services taxed by sales taxes. The median state taxes 55 of 168 services: North Carolina taxes 30.[2]

3. The committee discussed principles for tax modernization, namely equity, efficiency, sufficiency, competitiveness, and simplicity in administration and compliance

4. Committee members were asked to discuss their views on sales taxes, based on the principles enumerated above. The committee discussed whether its charge included determining tax rates, determining tax structure, or both. The point was made that the committee should focus on revenue neutral changes in tax structure. The statutory tax rates and the level of tax collections will be set by the States' political leaders, based on State needs.

5. It was suggested that North Carolina's differential sales tax rates may be inequitable. Differential rates make administration and compliance with sales taxes more difficult, but do not appear to have an economic justification. The committee discussed sales tax exemptions. The exemption for food for home consumption received special attention. Middle and upper income families benefit most by the food exemption. The food exemption narrows the base, and requires higher tax rates elsewhere, reducing competitiveness. A more efficient and equitable approach to aiding poor families would be to tax sales of food, and use some of the revenue collected to target benefits to poorer families.

6. North Carolina's sales tax is levied, primarily, on tangible goods: few services are taxed. A committee member asked if services should be included in the sales tax base. Not taxing services produces many adverse effects: i) it puts producers of tangible goods at a competitive disadvantage; ii) it produces a relatively light tax burden on households that consume disproportionate amounts of services; iii) it results in a sales tax base that is more variable over the business cycle; iv) it causes the sales tax base to erode, as spending shifts away from goods, toward services. Sales tax base erosion requires higher tax rates than otherwise would be the case. Taxing services would broaden the sales tax base, reducing base erosion. Therefore, a revenue neutral broadening of the sales tax to services would permit a decrease in the tax rate. A lower tax rate would tend to improve North Carolina's ability to compete. Some people and businesses may base location decisions, at least in part, on the level of tax rates. Broadening the base, and lowering rates, could improve North Carolina's attractiveness for such groups. Concern was expressed about how broad taxation of services should be. Should professional services (E.G., accounting, legal, and architectural services) be taxed? Most states do not tax

[1] Georgia, South Carolina, and Tennessee depend more than North Carolina on sales taxes. Kentucky and Virginia depend less than North Carolina on sales taxes.
[2] Federation of Tax Administrators' 2004 survey of sales tax on services.

- Local governments should be authorized to increase the deed stamp tax at local option to fund infrastructure needs driven by growth, including transportation.
- Local governments should be authorized to assess a higher motor vehicle license tax within reasonable limits (currently cities have general authority to assess up to $5.00 per year on all vehicles that are resident in their jurisdiction).
- Local governments should be given flexibility to use Powell Bill funds to fund projects on state roads.

V. Issues yet to be reviewed by the subcommittee including a plan for addressing those issues

The Subcommittee notes that there is incredible demand for infrastructure in our rapidly growing state. The subcommittee intends to research the current state-local distribution of responsibilities for, and projected future needs of, the State's Community College System, court facilities and technology infrastructure. The Subcommittee's future work must also rely on interactions with other subcommittees on their work on revenue generation and program responsibilities. For instance, the local option land transfer tax may not be appropriate to meet the needs of all counties for infrastructure, and Medicaid relief, as being discussed by another subcommittee, may be a more appropriate way to provide the ability to finance infrastructure for those counties.

VI. Other matters that you would like to bring before the full commission.

- Local government revenue authority has a distinct component for infrastructure financing.
- Authority should be broad enough for local governments – including counties and municipalities – to have local discretion over the allocation of that authority.
- There should be some connection between the revenue authority and the demand and responsibility for public infrastructure; that is, growth financing the expanded infrastructure.

Debt

Bonds are not free. North Carolina and its local governments are the best-managed in the United States. A conservative use of debt and respect for debt affordability is a key component of that recognition and tradition. To that end, the subcommittee recommends:

- That the State's debt affordability guidelines be followed, unless there are increases in the State's revenue capacity or decreases in the State's programmatic responsibilities to free up capacity. If that occurs, priority consideration should be given to public school construction, transportation infrastructure, and water, sewer, and stormwater infrastructure after state facility needs are met.
- That the Treasurer provides information on relative debt capacity for local governments.

Equity

Benefits Received

Some public infrastructure can be financed by those who benefit most directly from the capital investment. The subcommittee recommends that the Committee consider the following:

- DENR and other organizations should provide training on water and sewer rate setting and rate structures to provide sound operation, maintenance and accountability for availability of water.
- Where appropriate, tolls and public-private partnerships may be used to finance transportation projects and increase the speed of completion.
- Proxies for use of roads and highways should remain the prevailing source of revenues for these purposes (*e.g.* gas tax, highway use tax).

State-Local Partnerships

As noted above, the subcommittee acknowledges that the state and local division of labor over infrastructure has been blurred substantially. The state has $265 million in debt service for items that were exclusively local in nature. Cities testified that they were spending money on state-owned roads, and some counties have an interest in supporting transportation infrastructure. To that end, the subcommittee recommends the following:

- ***Public School Construction***

  - The current estimated need from DPI is $9.8 billion over the next five years.
  - Public schools are the largest component of county debt outstanding, with over $6.3 billion outstanding on June 30, 2006. Schools comprise 66 percent of the total county debt.
  - The state has shared the sales tax base with local governments, including specific requirements that certain percentages be used for public school capital.
  - The state also provides a share of the corporate income tax and the education lottery for school construction projects.

- ***Water, Sewer, Stormwater Infrastructure***

  - The current estimated need is $6.85 billion over the next five years.
  - Water and sewer is the largest component of municipal debt outstanding, with $3.5 billion outstanding on June 30, 2006. Water and sewer comprise 46 percent of municipal debt. Water and sewer is the second largest component of county debt, with almost $500 million outstanding on June 30, 2006.
  - Most of this debt and operational costs for water and sewer are funded through user fees.
  - The state has provided more money than many other states for water and sewer in the past few years, but the 1998 bond money is almost all depleted.
  - The Governor recommends $250 million in state bonds for water and sewer.

- ***Transportation Infrastructure***

  - DOT has estimated the need gap at $65 billion over 25 years, more than double the current state revenues for transportation.
  - State revenues for transportation are fairly flat this year.
  - Municipalities have $785 million in street and highway debt outstanding.
  - The State spends $1.9 billion on construction and $876 million on maintenance.
  - The State gas tax is the highest in the region, though overall consumer taxes are lower due to no local sales tax dedication and lower than average sales tax on cars.
  - Locals receive a share of the gas tax in Powell Bill aid (about $150 million).

exceeded $927 million, averaging more than 11 percent of total expenditures. The costs are highest in large cities; however, the costs absorb a larger percentage of the budget for smaller municipalities. Mr. Mills indicated that transportation costs continue to rise. Municipal spending on transportation in fiscal year 2004-05 represented a 23 percent increase over fiscal year 2002-03 expenditures. The increase is the result of both increases in the price of gasoline and asphalt and also the growth in municipal road mileage. According to data cited by Mr. Mills, the State provides over $100 million each year to 502 municipalities for transportation infrastructure (Powell Bill funds). The growth in Powell Bill funds has not kept pace with the growth in transportation costs, however. The funding has increased 3.4 percent over the past three years. And, available Powell Bill funding only covers a portion of transportation costs, especially in large cities. The funds cover about 12 percent of the largest cities' transportation costs and about 27 percent of other cities' costs. Mr. Mills suggested that some potential solutions include: (1) improving the road construction project approval process by further streamlining the permitting process; (2) continuing to look to innovative financing mechanisms, such as allowing cities to "loan" the money to the NC Department of Transportation to get projects done earlier, use of Garvee bonds, implementation of toll roads, and assessment of VMT tax; (3) considering public-private partnerships for roads; and (4) providing local governments with a greater menu of local funding options. A few municipal transportation directors accompanied Mr. Mills and briefly addressed the subcommittee. They echoed Mr. Mills' remarks that State funds are not keeping pace with local needs for transportation infrastructure funding. They also indicated that the State should look towards more regional solutions to planning and funding transportation projects.

The subcommittee also received reports on transportation funding and best practices from the NGA Center for Best Practices and the North Carolina Aggregates Association.

Debt Capacity

Vance Holloman, Deputy Treasurer, NC Department of State Treasurer

- Mr. Holloman reviewed debt options available to local governments and the Local Government Commission's process of evaluating debt capacity. As of June 30, 2006, North Carolina counties had approximately $9.5 billion debt outstanding, approximately two-thirds of which is related to school construction. North Carolina cities had approximately $7.7 billion debt outstanding, over 50 percent of which is related to water and sewer or transportation infrastructure. The average county direct tax-supported debt per capita is $1,163, with a high of $4,291 (Dare County) and a low of $29. The average city direct tax-supported debt per capita is $642, with a high of $23,077 (Indian Beach) and a low of $0. Evaluating debt as a percentage of assessed valuation, the county average is 1.405 percent, with a high of 3 percent (Johnston County) and a low of .042 percent. The city average is .741 percent, with a high of 2.293 percent (Cary) and a low of

conditions on State funding that ensure financial, technical and managerial efficiency of operations; (5) provide funding for regular updates to the State water and wastewater data layers; and (6) fund phase II of the State stream mapping project.

Jean Klein, Klein Consulting

- Ms. Klein presented data on the state of water and wastewater systems in North Carolina. She noted that the majority of systems are small and that the costs to operate these systems are high compared to those of larger systems. Ms. Klein further indicated that there are over 19,000 households across North Carolina currently without water and sewer services—most located in poorer, rural areas where extension of existing water infrastructures is not economically feasible for the local governments. Ms. Klein suggested that the State needs to set policies and funding directives to encourage continued regionalization of water infrastructure.

Jeff Hughes, Director, NC Environmental Finance Center, UNC-Chapel Hill School of Government

- Mr. Hughes discussed a 2005 water and sewer rate survey conducted by the NC Environmental Finance Center and NC League of Municipalities. The survey sampled approximately 333 water and sewer utilities across the State and found that there is significant variation in the rates and rate structures and also variation in operating ratios. According to the survey results, small town systems and systems serving unincorporated areas tend to charge significantly higher rates than larger municipal systems. Despite the higher rates, the small systems often do not collect enough to cover their current operating costs, let alone the costs of capital improvements or expansions. Newer systems also tend to have higher rates than established systems because they often serve lower density rural areas and the federal government no longer makes the significant investments in systems that it made in the 1970s and 1980s. Further, the increased environmental sensitivity and subsequent regulation in some watersheds has influenced rates in those regions. With respect to regionalization, Mr. Hughes stated that North Carolina has relatively few independent regional entities—most regional utilities are actually county systems or city systems with inter-local agreements. Many potential regionalization plans have public and financial advantages at the aggregate level but never advance for political reasons and because average aggregate costs usually do not drive local decisions. Mr. Hughes commented that State investments in water infrastructure have been on par or greater in North Carolina than other southeastern states in the recent past, but these investments have been made in a feast-or-famine manner. The swings in State funding assistance have had some negative impacts on how projects are planned and built. Accordingly, Mr. Hughes believes that future best practices at the State level include longer term financing, leveraging, facilitating co-funding packages, and careful analysis of rates in determining grant allocations. At the

III. Speakers providing information to the subcommittee, a summary of the presentations and a global summary of the subcommittee's research to date

Presentation Summaries

School Construction and Community Colleges Financing

Dr. Ben Matthews, Director, School Support Division, NC Department of Public Instruction

- Dr. Matthews reviewed the 2005-2006 North Carolina Public Schools' Facilities Needs Survey. (The survey must be performed every five years, pursuant to N.C. Gen. Stat. § 115C-521(a), requiring "Local boards of education [to] submit their long-range plans for meeting school facility needs to the State Board of Education . . . every five years . . . . In developing these plans, local boards of education shall consider the costs and feasibility of renovating old school buildings instead of replacing them.") According to the survey results, local school boards' projected needs over the next five years for new schools, furnishings and equipment, land acquisition, and additions and renovations to existing elementary, middle, high school and other facilities totals approximately $9.8 billion. One-third of this amount reflects needs in the largest six counties. The projected needs represent an increase of 150% over the last survey (2000-01), mainly due to construction cost inflation and population increases. In today's dollars, the cost of new construction averages about $23,278 per student. Dr. Matthews also reviewed various revenue sources available to local governments for school construction projects, including various debt options, public-private partnerships, sales tax earmarks, and federal aid programs.

Rebecca Troutman, Director of Research and Public Technology, NC Association of County Commissioners

- Ms. Troutman provided subcommittee members with a written comparison and brief explanation of required school capital funding set-asides for 2005-06 (including Article 40 and Article 42 local sales and use taxes earmarks, ADM fund allocation), projected lottery proceeds for 2006-07, and five year capital needs for each county (from the 2005-06 survey). The total required capital funding set aside for all counties for 2005-06 was approximately $404 million and the projected lottery proceeds for 2006-07 is $140 million. The required funding supports approximately 28 percent of the total school facility needs across the State when comparing the five-year revenue of these sources to the total five-year capital needs cost.

less and place a cap on the tax on our per transaction basis. Such a tax should be kept small so as not to impede the transfer of property.

Recommendation:

Real estate transfer taxes should be one of the options given to local governments. However, real estate taxes should be designed so as not to impede the transfer of property. A study should be commissioned to determine the appropriate rates, caps, and exclusions. Additionally, it would be appropriate for tax revenues from real estate taxes to be targeted towards expenses that generally increase the value of property, such as local infrastructure.

Impact Fees

A small number of counties in North Carolina currently have impact fees as an option. It is primarily a benefit in high growth counties. Impact fees should be available as an option, and like real estate transfer taxes, the fee should be capped and revenues targeted towards costs that generally increase the value of property.

Vehicle Use Tax

A $10 per year vehicle use tax would yield about a 1% increase in local tax revenue. Authority should be given to all municipalities to set the vehicle use tax at the same level.

V. Issues yet to be reviewed by the subcommittee including a plan for addressing those issues

None.

VI. Other matters that you would like to bring before the full commission

The subcommittee identified two other issues that warrant consideration. First, the need for infrastructure at the local level is great in the years to come. The state should encourage an integrated capital spending plan to ensure that the highest priority needs are being addressed.

Secondly, in order to meet the significant financial needs of the future, local governments should consider greater consolidation of services to ensure that services are being delivered as efficiently as possible. Counties should work together to create regional means of delivering

3. Review the following taxes and fees to determine whether any changes are needed to align the revenue sources in accordance with the general tax principles set out below:
    a. Sales taxes
    b. Property taxes
    c. Real estate transfer taxes
    d. Impact fees
    e. Vehicle use fees.

4. Identify ways to broaden the tax base, lower tax rates, and eliminate special exemptions and rates consistent with the tax principles.

Sales taxes

Sales taxes represent the best opportunity to broaden the tax base and lower tax rates. Since sales taxes currently only apply to goods, taxing services would significantly broaden the tax base. Based on the "tax calculator" model used by the subcommittee, taxing all services would increase revenues at the local level by approximately 50% if the sales tax rates remain at the current level. A sales tax rate of 1.25% on all services and all currently taxed goods would yield an increase in local revenues of about 10%. Alternatively, taxing all services, excluding housing, could allow property taxes to be reduced by one-third. Our subcommittee looked at two counties with significantly different characteristics, Wake and Bertie, and found that broadening sales taxes to include services resulted in a similar percent increase in sales tax revenue for each county. Clearly, broadening the sales tax base to include services would give local governments flexibility they don't currently have to meet rising costs or provide property tax relief.

Recommendation:

Sales taxes should be broadened to include services. An earned income tax credit targeted towards low income households should be developed if sales taxes are applied to housing and groceries.

Two additional issues warrant further consideration: 1) The distribution of sales tax revenues should be reviewed potential inequities, and 2) lost revenue associated with internet sales should be addressed through federal regulation.

III. Speakers providing information to the subcommittee and a summary of the presentations

Mr. Mike Walden, Professor, N. C. State University

1. Summary of total revenue by source for Wake and Bertie Counties. This presentation provided insight as to how much revenue was coming from different sources in two different counties, one urban, one rural.
2. An analysis of property tax revenue as a percentage of total personal income for all counties.
3. A listing of local sales tax exemptions and services requiring licenses.
4. Presentation of the impact of various taxing options using the "tax calculator"

Mr. Jan Winters, County Manager, Gaston County

1. Spreadsheet comparing the projected growth in property tax and sales tax revenue to the projected increases in current expenses for education, debt service on capital expenses for education, and projected Medicaid expenses over the next five years.

IV. Specific recommendations (with a discussion of the reasoning and explanation for those recommendations)

1. Determine whether the portfolio of taxes and fees and mix of revenue sources at the local level is appropriate.

   Currently, local governments depend primarily on property taxes and sales taxes for their revenues. While these taxes may be appropriate for some local governments, the needs of communities in North Carolina vary greatly. For example, high growth communities often are in need of more infrastructure, while other areas may have high operating costs associated with Medicaid. The revenue options available today do not provide enough flexibility for local governments to meet the needs of its citizens. A limited number of counties have received approval from the legislature to utilize additional taxes and fees such as real estate transfer taxes, prepared food taxes, occupancy taxes, and impact fees. These additional revenue options have given this limited number of local governments' flexibility to address their local needs.

V. Issues yet to be reviewed by the subcommittee including a plan for addressing those issues

1. Allowable deductions and exemptions for individual income tax purposes – The subcommittee discussed whether deductions for social security benefits, mortgage interest and charitable contributions should be allowed from a broadened AGI tax base. Further review and analysis needs to be undertaken with respect to the implications of allowing some or all of the deductions. Additionally, there will be tension between the allowable deductions and exemptions and the ability to lower the tax rate. Simply stated, an increase in allowable deductions and exemptions will result in a higher revenue-neutral tax rate.
2. Progressivity within the individual tax rate structure – The subcommittee concluded that some progressivity within the individual tax rate structure is necessary but the degree to which progressivity exists needs to be determined.
3. Threshold for requiring the filing of an individual income tax return – The subcommittee did not determine the threshold for requiring the filing of an individual income tax return. This subcommittee could address this issue in future deliberations if its life is extended beyond the current expiration date.
4. See Recommendation No. 6 – This subcommittee could conduct the review which it has recommended contingent upon its life being extended beyond the current expiration date.
5. Business credits & incentives – The subcommittee understands that a new committee has been constituted whose charge is to review these issues. In light of this new development, the subcommittee agreed not to review these items but rather to defer to this new committee.

VI. Other matters that you would like to bring before the full commission

None.

IV. Specific recommendations (with a discussion of the reasoning and explanation for those recommendations)

Recommendation No. 1 – *Broaden the individual income tax base to federal AGI with minimal deductions and exemptions.* Broadening the tax base would allow the state to reduce the tax rate (see Recommendation No. 2) in order to provide more stability in this revenue source as well as to be more competitive with our southeastern states. Income from U.S. government obligations and *Bailey*-related retirement benefits would still be excluded from taxation. The subcommittee also recommends that appropriate measures be considered to ensure that the tax burden of lower-income taxpayers is not increased.

Recommendation No. 2 – *Reduce the top marginal individual income tax rate to a rate that is competitive with other southeastern states.* Other southeastern states have top marginal tax rates ranging from 5.75% to 7% and therefore, the subcommittee recommends that the state's top tax rate be reduced to approximately 6% (while maintaining some progressivity within the overall rate structure) in order to assist in promoting a competitive advantage for the state when competing for economic development opportunities.

Recommendation No. 3 - *Reduce the number of individual income taxpayers by eliminating the filing requirement of those with immaterial taxable income and who pay an insignificant amount of income tax.* The subcommittee noted a significant number of individual income taxpayers with immaterial taxable income and who pay an insignificant amount of income tax. Adhering to this recommendation would appear to significantly reduce the compliance burden of lower-income taxpayers and the Department of Revenue.

Recommendation No. 4 – *Broaden the corporate income tax base by repealing the existing separate entity reporting system and enacting a combined reporting regime for related entities.* Broadening the tax base promotes stability in the tax revenue (less volatile during weak economic conditions) and would allow for a reduction in the corporate income tax rate (see Recommendation No. 5). Combined reporting provides the broadest tax base than any other reporting system and therefore, would provide the most stable revenue base and the lowest tax rate. The subcommittee noted the lack of combined reporting in the southeast which might be viewed as a competitive disadvantage. However, the subcommittee believes that this perceived disadvantage would be partially mitigated when coupled with a reduction in the corporate tax rate.

iii. Sufficiency – A tax system should provide the government with a sufficient and predictable source of revenue without having to resort to rate increases.

iv. Efficiency – A tax system should be efficient and not impede or reduce the productive capacity of the economy.

v. *Competitiveness – A tax system should be competitive with other states in order to promote long-term, sustainable economic development, job creation and growth.*

Note: Items in italics are amendments to the charge made by and agreed to by the subcommittee.

II. Issues dealt with over the last two months

1. Review and approval of the subcommittee's charge and related tax principles.
2. Tax revenue impact and other implications of moving to expanded tax bases and lower tax rates.
3. General understanding of the most recent tax reform activities in Ohio and Texas to include any "lessons learned".
4. Overview of the current taxing systems (corporate income and franchise, individual income and estate & gift), the existing weaknesses therein and possible solutions thereof.

III. Speakers providing information to the subcommittee and a summary of the presentations

Dr. Douglas A. Shackelford, Senior Associate Dean for Academic Affairs and Meade H. Willis Distinguished Professor of Taxation, Kenan-Flagler Business School, University of North Carolina – Dr. Shackelford provided the subcommittee with information surrounding Ohio's Commercial Activity Tax and Texas' Alternative Margins Tax.

Mr. Karl Smith, Graduate Fellow of the Institute for Emerging Issues and PhD Candidate in Economics at North Carolina State University – Mr. Smith provided an overview and demonstration of the "tax calculator" program which he developed. Additionally, he provided the subcommittee with an opportunity to propose different scenarios in order to determine the approximate impact on the various tax revenues.

STATE AND LOCAL FISCAL MODERNIZATION STUDY COMMISSION

Monday, April 16, 2007
Room 544, Legislative Office Building
10:30 a.m.

I. Opening Remarks and Approval of Minutes

II. Recap and Discussion of Subcommittee Recommendations
Roby Sawyers

III. Incidence Analysis of Recommendations
Matt Gardner, Executive Director of the Institute on Taxation and Economic Policy, Washington, DC

IV. Lunch (Subcommittees will meet and rank order the subcommittees' recommendations)

V. Summary of Rankings, General Discussion and Implications for Recommendations to the General Assembly
Roby Sawyers

VI. Adjournment

VISITOR REGISTRATION SHEET

Fiscal Modernization Study Commission — April 16, 2007

Name of Committee — **Date**

VISITORS: PLEASE SIGN IN BELOW AND RETURN TO DeANNE MANGUM

NAME	FIRM OR AGENCY AND ADDRESS
Gordy Bigelow	N.C. Chamber Network.
Cam Brawley	E&Y
Dean Mills	NCMC Incum
Dennis Patterson	OSC
Sara Warren	Wake Gov
Rita Harris	NC State Ports Auth
Jean Beaver	
Marc Finlayson	Highway 17 Association
Amy McContey	Smith Anderson
Mary Klenz	League of Women Voters NC
June Kimmel	"

VISITOR REGISTRATION SHEET

Fiscal Modernization Study Commission — April 16, 2007

Name of Committee — **Date**

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BERRY JENKINS	CAROLINAS A.G.C.
Christie Barber	CHPA
[illegible]	NCSR
Barbara Cansler	BSCOE
Fred Allen	NC Aggregates Assn.
Greg Thompson	N.F.I.B
JOHN GOODMAN	NC CHAMBER
Penny Cummings	NC Assoc of County Comm

VISITOR REGISTRATION SHEET

Fiscal Modernization Study Commission — April 16, 2007

Name of Committee — **Date**

VISITORS: PLEASE SIGN IN BELOW AND RETURN TO DeANNE MANGUM

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Jan Winters	Gaston County
Jason Carnagey	NC Policy Watch
Meg Gray	NC Budget & Tax Center
Melinda Lawrence	NC Justice Center
Cliff Vandik	Law Office
Jean Reaves	Halifax Co.
Eric Fletcher	NC DST
Rhenna Trondm	NCACC
DAVID THOMPSON	NCACC
Larry Goode	NCGA

1

Subcommittee Recommendations

Recommendations of the Income Tax Subcommittee

In addition to the general tax principles agreed to by the Commission, the Income Tax Subcommittee adopted the additional principle that "the tax system should be competitive with other states in order to promote long-term, sustainable economic development, job creation and growth.

(1). Reduce the top marginal individual income tax rate to a rate that is competitive with other southeastern states.

(2). Broaden the individual income tax base to federal adjusted gross income with minimal deductions and exemptions.

(3). Reduce the number of individual income taxpayers by eliminating the filing requirement of those with immaterial taxable income and who pay an insignificant amount of income tax.

(4). Reduce the corporate income tax rate to a rate that is competitive with other southeastern states.

(5). Broaden the corporate income tax base by enacting a combined reporting regime for related entities.

(6). Conduct a comprehensive review of the corporate franchise tax in conjunction with recommendation number 5 in order to alleviate any possible compliance burdens as a result of two corporate tax reporting systems.

(7). Repeal the estate and gift taxes.

(8). Reduce North Carolina's reliance on the individual income tax. (increase sales taxes)

Recommendations of the Sales and Excise Tax Subcommittee

(1). Broaden the sales tax base to include services in a revenue neutral manner and lower the sales tax rate.

(2). North Carolina should eliminate differential rates in the sales tax as well as sales tax exemptions (including the food exemption). Some mechanism should be provided to relieve lower income households from any additional tax burden.

(3). Move all excise taxes to an ad-valorem basis.

(4). Include privilege taxes as sales/use taxes or eliminate them.

Recommendations of the Infrastructure Responsibilities and Funding Subcommittee

The Subcommittee recommended that certain general principles should be followed including that the State of North Carolina and local governments should use debt conservatively and follow the State's debt affordability guidelines, that any shift from local governments to state government (and vice versa) for funding responsibility must include a swap of revenue authority, and that public infrastructure should be financed by those who benefit most directly from the capital investment.

(1). Local governments should be given additional options to finance and support local infrastructure. Options should include a local option deed stamp tax and higher motor vehicle license taxes (basically the same as Local Tax Subcommittee Recommendation # 1 and Program Responsibilities Subcommittee Recommendations #4).

(2). Where appropriate, tolls roads and public/private partnerships may be used to finance transportation projects and increase the speed of completion. Proxies for the use of roads and highways such as the gas tax and highway use tax should remain the prevailing source of revenues for these purposes.

(3). Local governments should be given flexibility to use Powell Bill funds for projects on state roads.

(4). The State should issue bonds to replace the 1998 Clean Water Bonds. Funds from these bonds should be allocated to local utilities that have the greatest need and should be used to provide incentives to regionalize or otherwise provide more cost effective services.

(5). Local governments should assess user rates to cover both capital and operational costs of providing water and sewer infrastructure.

(6). The State should consider increasing the sales tax on vehicles and weight-based registration fees.

(7). The State should consider reducing reliance on the gas tax and using alternative proxies for road use such as an increased vehicle sales tax, motor vehicle license tax, or mileage based fees that would lead to additional resources for transportation infrastructure.

#2

Sales Tax on Services

Federation of Tax Administrators
March 1, 2007

	NC	Number of Taxing States	Avg Tax Rate	
Basic Sales Tax Rate	**4.25**	**As of July 1, 2004**		*1
Agricultural Services				
1 Soil prep., custom baling, other ag.	E	4	3.22	
2 Veterinary (both large and small animal)	E	5	2.98	
3 Horse boarding and training (not race horses)	E	6	3.36	
4 Pet grooming	E	18	4.91	
5 Landscaping (including lawn care)	E	20	5.33	
Industrial and Mining Services				
6 Metal, non-metal and coal mining	E	6	3.48	
7 Seismograph & Geophysical	E	6	3.65	
8 Oil Field	E	10	3.90	
9 Typesetting; platemaking for the print trade	E	20	5.30	*2
Construction				
10 Gross Income of Const. Contractors	E	12	4.27	
11 Carpentry, painting, plumbing and similar trades	E	13	4.98	
12 Construction service (grading, excavating, etc)	E	11	4.86	
13 Water well drilling	E	10	4.70	
14 Income from intrastate transp. of persons	E	11	4.36	
15 Local transit (intra-city) buses	E	5	3.53	*3
16 Income from taxi operations	E	8	4.16	
17 Intrastate courier service	E	6	3.78	
18 Interstate air courier (billed in-state)	E	1	4.00	
Storage				
19 Automotive storage	E	19	5.68	
20 Food storage	E	9	4.50	
21 Fur storage	E	16	4.75	
22 Household good storage	E	13	4.59	
23 Mini-storage	E	13	4.52	
24 Cold Storage	E	13	4.73	
25 Marina service (docking, storage, cleaning, repair)	E	18	4.96	*4
26 Marine towing service (incl. tugboats)	E	8	4.02	
27 Travel agent services	E	3	3.43	
28 Packing and crating	E	10	4.32	

Utility Service-Industrial Use					
29	Intrastate telephone & telegraph	6	44	5.19	
30	Interstate telephone & telegraph	6	26	5.81	
31	Cellular telephone services	6	40	5.32	
32	Electricity	3	37	4.97	*5
33	Water	E	18	4.92	*6
34	Natural gas	E	37	4.92	*7
35	Other fuel (incl. heating oil)	4.5	38	5.19	*8
36	Sewer and refuse, industrial	E	13	4.61	
Utility Service-Residential Service					
37	Intrastate telephone & telegraph	6	41	5.41	
38	Interstate telephone & telegraph	6	26	5.81	
39	Cellular telephone services	6	43	5.44	
40	Electricity	3	24	4.82	*9
41	Water	E	12	4.98	*10
42	Natural gas	E	22	4.72	*11
43	Other fuel (incl. heating oil)	4.5	23	5.02	
44	Sewer and refuse, residential	E	9	4.13	
Finance, Insurance, & Real Estate					
45	Service charges of banking institutions	E	3	3.83	
46	Insurance services	E	6	3.41	
47	Investment counseling	E	6	3.31	
48	Loan broker fees	E	4	3.88	
49	Property sales agents (real estate or personal)	E	5	2.98	
50	Real estate mgmt fees (rental agents)	E	5	2.98	
51	Real estate title abstract services	E	5	3.98	
52	Tickertape reporting (financial reporting)	E	8	4.11	
Personal Services					
53	Barber shops and beauty parlors	E	7	3.70	
54	Carpet and upholstery cleaning	E	18	4.91	*12
55	Dating services	E	8	4.61	
56	Debt counseling	E	7	3.84	
57	Diaper service	4.5	23	4.90	
58	Income from funeral services	4.5	14	4.30	*13
59	Fishing and hunting guide services	E	10	4.86	
60	Garment services (altering &repairing)	E	19	5.13	
Business Services					

61	Gift and package wrapping service	E	21	5.07	
62	Health clubs, tanning parlors, reducing salons	E	21	5.25	
63	Laundry and dry cleaning services, coin-op	E	6	4.48	
64	Laundry and dry cleaning services, non-coin op	4.5	23	5.17	
65	Message services	E	10	4.46	
66	900 Number services	6	29	5.75	
67	Personal Instruction (dance, golf, tennis, etc)	E	6	3.48	
68	Shoe repair	E	20	5.17	*14
69	Swimming pool cleaning & maintenance	E	17	5.17	
70	Tax return prep	E	6	3.48	
71	Tuxedo rental	4.5	39	5.30	
72	Water softening and conditioning	E	13	4.59	
73	Billboards	E	5	3.38	
74	Radio & TV, national advertising	E	2	2.19	
75	Radio & TV, local advertising	E	4	2.47	
76	Newspaper	E	4	2.47	*15
77	Magazine	E	5	3.07	*16
78	Advertising agency fees	E	11	4.56	
79	Armored car services	E	15	4.79	
80	Bail bond fees	E	4	2.97	
81	Check & debt collection	E	8	4.14	
82	Commercial art and graphic design	4.5	21	5.16	
83	Commercial linen supply	4.5	31	5.05	
84	Credit information, credit bureaus	E	12	4.99	
85	Employment agencies	E	10	4.39	
86	Interior design and decorating	E	9	3.79	*17
87	Maintenance and janitorial services	E	19	5.01	
88	Lobbying and consulting	E	7	3.84	
89	Marketing	E	6	3.48	
90	Packing and crating	E	9	4.08	
91	Exterminating (includes termite services)	E	19	5.35	
92	Photocopying services	4.5	43	5.34	*18
93	Photo finishing	4.5	44	5.30	*19
94	Printing	4.5	45	5.31	*20
95	Private investigation (detective) services	E	14	4.67	
96	Process server fees	E	6	3.48	
97	Public relations, mgmt consulting	E	7	3.84	

98	Secretarial and court reporting services	E	8	4.11	
99	Security services	E	16	4.84	
100	Sign construction and installation	E	29	5.40	*21
101	Telemarketing services on contract	E	6	3.48	
102	Telephone answering service	E	19	4.98	
103	Temp. help agencies	E	10	4.81	
104	Test laboratories (excluding medical)	E	8	3.86	
105	Tire recapping and repairing	E	28	5.26	*22
106	Window cleaning	E	18	4.95	
Computer					
107	Software-package or canned program	4.5	47	5.30	
108	Software-modifications to canned program	E	30	5.03	
109	Software-custom programs-material	E	25	5.15	*23
110	Software-customer programs-professional serv.	E	14	4.46	*24
111	Internet service providers-Dialup	E	11	5.89	
112	Internet service providers-DSL or other broadband	E	14	5.64	
113	Info services	E	12	4.09	
114	Data processing services	E	9	3.76	
115	Mainframe computer access and processing serv.	E	11	4.26	
Automotive Services					
116	Auto washing and waxing	E	21	5.25	
117	Auto road service and towing serv.	E	18	5.14	
118	Auto service. Except repairs, incl. painting & lube	E	24	5.32	
119	Parking lots & garages	E	20	5.55	
120	Auto rust proofing & undercoating	E	26	5.31	
Admissions & Amusements					
121	Pari-mutuel racing events	3	27	6.46	*25
122	Amusement park admission & rides	3	37	5.26	*26
123	Billiard parlors	E	27	5.32	
124	Bowling alleys	E	27	5.13	
125	Cable TV services	E	25	5.57	*27
126	Direct satellite TV	5	22	6.00	
127	Circuses and fairs -- admission and games	3	34	5.53	*28
128	Coin operated video games	E	18	4.81	
129	Admission to school and college sports events	3	22	5.67	*29
130	Membership fees to private clubs	E	22	5.46	

131	Admission to cultural events	3	33	5.42	*30
132	Pinball and other mechanical amusements	E	19	4.88	
133	Admission to professional sports events	3	37	5.43	*31
134	Rental of films and tapes by theaters	E	8	4.06	
135	Rental of video tapes for home viewing	4.5	45	5.36	
Professional Services					
136	Accounting and bookkeeping	E	5	2.98	
137	Architects	E	5	2.98	
138	Attorneys	E	5	2.98	
139	Dentists	E	4	2.72	
140	Engineers	E	5	2.98	
141	Land surveying	E	7	3.88	
142	Medical test laboratories	E	4	2.72	
143	Nursing services out-of-hospital	E	4	2.72	
144	Physicians	E	4	2.72	
Leases & Rentals					
145	Personal property, short-term (generally)	4.5	45	5.35	
146	Personal property, long-term (generally)	4.5	45	5.32	
147	Bulldozers, draglines and const. mach., short term	4.5	45	5.29	
148	Bulldozers, draglines and const. mach., long term	4.5	45	5.27	
149	Rental of hand tools to licensed contractors	4.5	45	5.35	
150	Short term auto rental	8	48	6.35	*32
151	Long term auto lease	3	38	5.42	*33
152	Limo service (with driver)	E	14	4.55	
153	Aircraft rental to individual pilots, short term	3	40	5.08	
154	Aircraft rental to individual pilots, long term	3	39	5.06	*34
155	Chartered flights (with pilot)	E	11	4.44	
156	Hotels, motels, lodging houses	4.5	48	6.06	*35
157	Trailer parks-overnight	E	27	5.67	
Fabrication, Installation & Repair Services					
158	Custom fabrication labor	4.5	38	5.34	*36
159	Repair material, generally	4.5	47	5.30	*37
160	Repair labor, generally	E	24	5.24	*38
161	Labor charges on repair of aircraft	E	19	5.17	
162	Labor charges - repairs to interstate vessels	E	12	5.07	
163	Labor charges - repairs to intrastate vessels	E	19	5.05	
164	Labor- repairs to commercial fishing vessels	E	15	4.96	

165	Labor charges on repairs to railroad rolling stock	E	11	4.65	
166	Labor charges on repairs to motor vehicles	E	22	5.18	
167	Labor on radio/TV repairs; other electronic equip	E	24	5.24	
168	Labor charges-repairs other tangible prop	E	24	5.24	
169	Labor-repairs or remodeling of real prop	E	14	4.86	
170	Labor charges on repairs delivered under warranty	E	7	4.34	
171	Service contracts sold at the time of sale of TPP	E	30	5.27	
172	Installation charges by persons selling prop	E	23	5.11	
173	Installation charges-other than seller of goods	E	18	5.18	
174	Custom processing (on customer prop)	E	26	5.32	
175	Custom meat slaughtering, cutting and wrapping	E	12	4.79	
176	Taxidermy	E	27	5.27	
177	Welding labor (fabrication and repair)	E	31	5.30	*39
178	Do you impose sales tax on other services not listed?	N			

*1 Items subject to the general State rate of sales or use tax are subject to the applicable local rate of tax.

*2 Typesetting exempt; sales of printing plates to manufacturers for use in their printing presses to imprint containers used to ship their manufactured products- 1% State, $80.00 maximum tax per article.

*3 Receipts are exempt. Buses are subject to the 3% state rate of highway use tax with maximum of $1,000.

*4 Parts and material only taxable.

*5 Sales of electricity to manufacturers, farmers, and commercial laundries and dry cleaners for the prescribed purposes are subject to a 2.83% rate of tax. Not subject to local taxes.

*6 Exempt if delivered through mains. Subject to a general state & local tax if delivered in bottles.

*8 Sales to commercial laundries freezer locker plants, manufacturers for use in connection with the industry or plant but not for residential heating purposes, farmers for other than household purposes, and commercial laundries are taxed at 1%. Not subject to local sales tax.

*9 Not subject to local taxes.

*10 Exempt if delivered through mains. Subject to the general state & local tax if delivered in bottles.

*11 Subject to an excise tax based on therms delivered; rates from .047 to .003 per therm.

*12 Rug cleaning services exempt if performed in home.

*13 First $1,500 of charge is exempt.

*14 Materials used in repair are taxable.

*15 Sales of newspapers by newspaper street vendors and by newspaper carriers making door-to-door deliveries and by vending machines are exempt. Sales of newspapers by others are subject to the general State sales tax and applicable local sales tax

*16 Sales of magazines by magazine vendors making door-to-door deliveries are exempt. Sales of magazines by others are subject to the general State sales tax and applicable local sales tax.

*17	Retail sales of tangible personal property by interior designers are subject to the general State tax and applicable local sales tax.
*18	Considered tangible property
*19	Considered tangible property
*20	Considered tangible property
*21	May be taxable, See Sales and Use Tax Administrative Rule .0805.
*22	Material only taxable.
*23	See G.S. 105-164.3(20)
*24	Generally not taxable; but see G.S. 105-164.3(20)
*25	Exempt under sales tax. Taxable under admissions tax statute.
*26	Exempt under sales tax. Charges for live entertainment are subject to amusement tax, admissions and rides are not taxable.
*27	Equipment rental by viewer is subject to the general state and local sales tax.
*28	Exempt under sales tax. Admissions to circus and fairs (certain agricultural fairs are exempted) are taxable under admissions tax statute; charges for games are not taxable.
*29	Exempt under sales tax. Admissions to elementary and secondary school events are not taxable. Admissions to college events are subject to admissions tax with certain exclusions based on the amount of the admission charge and age of participants.
*30	Exempt under sales tax. Taxable under admissions tax statute.
*31	Exempt under sales tax. Taxable under admissions tax statute.
*32	Exempt from sales tax. Vehicles subject to Highway Use tax. Short term lease is less than 365 continuous days.
*33	Exempt from sales tax. Vehicles subject to Highway Use tax. Long term lease is 365 continuous days or longer.
*34	$1,500 maximum tax.
*35	Exempt after 90 continuous days to the same person.
*36	Considered a part of sales price.
*37	Taxable at 1% or 4.5% whichever is applicable.
*38	Repair labor is exempt if separately stated on invoice from the tangible personal property. Material is taxable at 1% or 4% rate, whichever is applicable.
*39	Fabrication labor is part of sales price of tangible personal property. Repair labor exempt if separately stated on customer's invoice.
**	North Carolina now applies the regular combined general state and local rate to telecommunications, cable TV and satellite TV.
***	Prepaid telephone charges are taxed as tangible personal property at the regular state rate
****	Satellite radio is taxed as tangible personal property at the regular rate.

*****

The general rate in NC was 4.5% on July 1, 2004, it was reduced to 4.25% on December 1, 2006 and is scheduled to decrease to 4% on July 1, 2007

NORTH CAROLINA
ASSOCIATION OF COUNTY COMMISSIONERS

Land Transfer Tax

Revenue options are a priority legislative goal of North Carolina county governments

Seek legislation to allow all counties to enact any or all of several revenue options from among those that have already been authorized for any other county, including local option sales taxes, impact taxes and real estate transfer taxes.

What is a Land Transfer Tax?

- A land transfer tax is not a recurring tax but is a sales tax on the value of real property, both commercial and residential, when the property is sold.
- A one percent land transfer tax would generate nearly $800 million annually for counties and cities to meet their infrastructure needs.

Why Do Local Governments Need a Land Transfer Tax?

- A land transfer tax targets revenues to high-growth areas so that counties and cities can address rapidly increasing infrastructure needs, such as schools ($10 billion), roads ($10 billion for city needs), and water and sewer ($7 billion).
- A local-option land transfer tax keeps the revenues in the community where it is levied.
- A land transfer tax eases pressure on rising property taxes so that long-time residents, many of whom are retired and living on fixed incomes, can afford to stay in their homes.
- Six counties in North Carolina – Camden, Chowan, Currituck, Dare, Pasquotank and Perquimans – already have a land transfer tax, which has helped them keep pace with growth without huge increases in property tax rates.
- Since 2000, four of these counties rank among the fastest growing in the state, experiencing growth significantly greater than the state's growth rate of 10 percent.
- Four of the top five counties in per capita spending on education have the land transfer tax.
- According to the Tax Foundation of Washington, D.C., 36 states already have a statewide or local land transfer tax.
- The U.S. Census Bureau projects that North Carolina's population will increase to 12 million by 2020, which will make us the seventh-largest state.
- These new citizens will lead to the construction of approximately 2.4 million new residential housing units.

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Tax not slowing growth

By BOB MONTGOMERY
Staff Writer

Sunday, April 15, 2007

Opponents of a proposal to allow all 100 North Carolina counties to impose a tax on real estate transactions say it could stunt growth because it will curb home sales.

But counties where land transfer taxes have been imposed for some time— including six in the Albemarle — are reporting just the opposite.

"We've had (the land transfer tax) since 1990 and it has not stymied growth at all," said Pasquotank County M anager Randy Keaton. "We're the 19th-fastest growing county in the state. Our land transfer tax (revenues) have been growing steadily. All (counties) that have (the tax) are probably having the fastest growth in the state."

Indeed, the Census Bureau recently reported that Pasquotank's population has jumped 13.5 percent in the past six years. Similarly, Dare County, which was the first county in the state to impose a land transfer tax in 1986, was the state's 20th-fastest growing county over the past six years. It's grown by 13.2 percent since 2000.

The same is true in Camden and Currituck counties, both of which have land transfer taxes. Camden has grown at a 34.7 percent clip since 2000, the second-fastest rate in the state. Currituck, which had the third-fastest growth rate in the six-year period, saw its population grow by 30.7 percent.

All four counties, and Perquimans, Chowan and Washington, sought legislative approval a number of years ago for the right to impose a 1 percent tax on the sale of all real estate. All successfully argued that they needed the revenue from the tax to pay for schools and other infrastructure needs because they lacked the traditional

types of property tax base — industrial and large commercial property —that help pay for those services elsewhere.

Land transfer taxes are paid by the buyer of real estate at time of the sale. At 1 percent, the tax would generate $1,000 for each $100,000 of a real estate transaction. For example, the tax on the sale of a $200,000 home would be $2,000.

Large real estate transactions can generate large amounts of revenue for counties with a land transfer tax. Last year, for example, Pasquotank County netted $106,000 in land transfer tax revenue when a Los Angeles developer bought the Port Elizabeth Shopping Centre in Elizabeth City for $10.6 million.

Land transfer taxes have had a significant impact on all six counties — Washington County voters rejected a referendum that would have imposed one — where they're being collected.

Camden County Manager Randell Woodruff recently told the Chatham Journal Weekly newspaper that Camden receives about $500,000 a year in land transfer tax revenues — a significant amount for a county with a budget of only about $10 million.

Currituck County Manager Dan Scanlon said his county garners between $5 million and $7 million a year in land transfer tax revenue.

Keaton said Pasquotank voters rejected the tax in a 1989 referendum but approved it in a subsequent referendum not long afterward. The county's revenues from the tax have increased nearly every year since.

"When we started it, we were getting about $500,000 a year," Keaton said. Now, the county earns about $2 million in transfer tax revenues, although the amount fluctuates with the growth rate.

Dare County collected $1.2 million the first year it collected the tax. In 2004, Dare collected $12.5 million, while issuing 3,464 building permits valued at $295 million, county officials told the Chatham Journal Weekly in May 2005.

That kind of success has caught the attention of state lawmakers, one of whom, state Sen. Bob Atwater, D-Chatham, now wants other counties to share in the wealth. Atwater has introduced a bill that would allow the other 93 counties in the state to hold voter referendums on a 1 percent land transfer tax. Atwater says the bill is needed because many are strapped by limited revenues in their response to explosive growth.

Atwater's bill is supported by the North Carolina Association of County Commissioners, because it is "tied closely to the real estate market and generates money to pay for growth at the time it is needed," according to the NCACC's Web site.

It is strongly opposed by the North Carolina Association of Realtors, however. The Realtors group believes Atwater's bill would create just another tax to be paid by homebuilders who then will pass it on to buyers, raising the cost of a home. The NCAR has launched a statewide campaign called, "Stop the NC Home Tax," urging lawmakers to reject Atwater's bill.

"I am very much opposed to further taxes on the backs of homeowners, especially in light of all the tax breaks that are being offered to big corporations to locate in N.C.," stated Tim Kent, executive vice president of the NCAR, on the organization's Web site.

Locally, however, officials said they've seen no proof that the tax has slowed growth or led to higher home prices.

"All of the counties in the northeast that have the land transfer tax are having problems with too much growth, instead of the reverse," Keaton said.

Scanlon agreed. He said the county's recent property re-valuation showed a tripling of land values over eight years.

"So I am hard-pressed to see where the transfer tax has had any negative impacts on the building practices here," he said.

If anything, the tax has helped boost growth, Scanlon said.

"Transfer taxes have allowed us to build quality schools — it enhances our development," he said. "One of the top things a person looking to move here looks at is schools and the infrastructure."

In all, Currituck has built four new schools — a high school, middle school and two elementary schools — thanks in large part to the land transfer tax, he said.

"If you didn't have the transfer tax, all you have to fall back on is the property tax," Scanlon said.

Perquimans County hasn't seen the rapid growth that Camden, Currituck and Pasquotank have experienced. Yet County Manager Bobby Darden still is thankful for his county's land transfer tax. The county has seen its revenue from the tax grow from

177,348 in 1997-98 to about $725,000 in 2005, he said.

Chowan County, the second county in the state to adopt the transfer tax, dedicates all its transfer tax revenues to capital projects. County Manager Cliff Copeland told the Chatham Journal Weekly that the county divides its revenues from the tax equally with the town of Edenton. By contrast, Pasquotank County doesn't share any of its transfer tax revenue with Elizabeth City.

Like Scanlon and Keaton, Copeland believes the tax has enhanced home sales, not stymied them.

"I believe all the real estate agents in the (Chowan) county will confirm that the transfer tax has not impacted real estate sales in a negative manner, but in fact has facilitated sales through improved infrastructure, schools," he told the Chatham Journal Weekly.

(Contact Bob Montgomery at

bmontgomery@coxnc.com)

Find this article at:
http://www.dailyadvance.com/search/content/news/stories/2007/04/15/0415TransferTaxRM.html

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NCACC POLICY BRIEF

Volume 1, Issue 1 APRIL 13, 2007

NC ASSOCIATION OF COUNTY COMMISSIONERS

LAND TRANSFER TAXES: THE NC EXPERIENCE

This policy brief draws on the experience of the six North Carolina counties with land transfer taxes. The success of these counties in utilizing this revenue source to provide high quality services to their citizens is attributable to two factors: 1) the stewardship of elected officials; and 2) the use of the proceeds to meet specified infrastructure needs.

Despite opposition from homebuilders and realtors, these counties have not suffered adversely from the implementation of these taxes. For each of these counties,

- home values remain affordable,
- job and retail growth remains robust,
- residential growth is vibrant,
- Schools are benefiting immensely,
- Property taxes remain stable.

These counties have benefited tremendously from the transfer tax because they have embraced three key principles: 1) taxpayer protection through tax limitation; 2) multi-pronged efforts aimed at Economic Development, 3) continuous monitoring of the effects of the local tax structure on citizens.

Author: Donnie Charleston
Policy/Research Analyst NCACC

Data for this report were obtained from:

The N.C. Department of Revenue; U.S. Census Bureau; The Tax Foundation, & the N.C. Department of Public Instruction

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Introduction

As North Carolina local governments begin the arduous task of addressing infrastructure needs, many local policymakers are seeing transfer taxes as part of the solution to a growing crisis.

Examining these six counties provides a lesson in how to accommodate dramatic growth, bolster funding to public schools and maintain a strong and vibrant economic base all while mitigating the impact on property tax increases.

In 1985, the General Assembly gave Dare and Currituck counties authority to levy a land transfer tax by resolution of the Board of County Commissioners Subsequent legislation the following year gave authority to Chowan and Camden counties to enact a land transfer tax by resolution. For all these counties, the tax was set at $1.00 per $100 (1%) on instruments conveying interest in real estate. For each of the counties, expenditure of the revenue was limited to capital expenditures (see chart below).

Authorizing Legislation	Method of Enactment	Required Use of Proceeds
Dare County Chapter 525 Session Law 1985	Resolution by Board of County Commissioners	Capital expenditures: Jails, Court facilities, EMS, libraries, recreation, education, health, social services, water, sewer, administration
Currituck Chapter 670 Session Law 1985	Resolution by Board of County Commissioners	Capital Expenditures: solid waste an county operated buildings
Chowan County Chapter 881 Session Law 1986	Resolution by Board of County Commissioners	Capital Expenditures (any lawful purpose)
Camden County Chapter 954 Session Law 1986	Resolution by Board of County Commissioners	Capital Expenditures (any lawful purpose)
Pasquotank County Perquimans County Washington County Chapter 393 Session Law 1989	Voter approval via public referendum	Capital Expenditures: Public Schools

In 1989, the authority was granted to Pasquotank, Washington and Perquimans counties. However, a stipulation was made in the law that the tax had to be approved through voter referendum. Pasquotank and Perquimans counties were successful in their efforts; however, Washington County voters failed to approve it on two occasions.

Since implementation, the land transfer tax has allowed these counties to: 1) reduce property taxes; 2) increase funding for economic development; 3) reduce reliance on borrowing to build schools; and 4) reduce the funding disparities between these school districts and the remainder of the state.

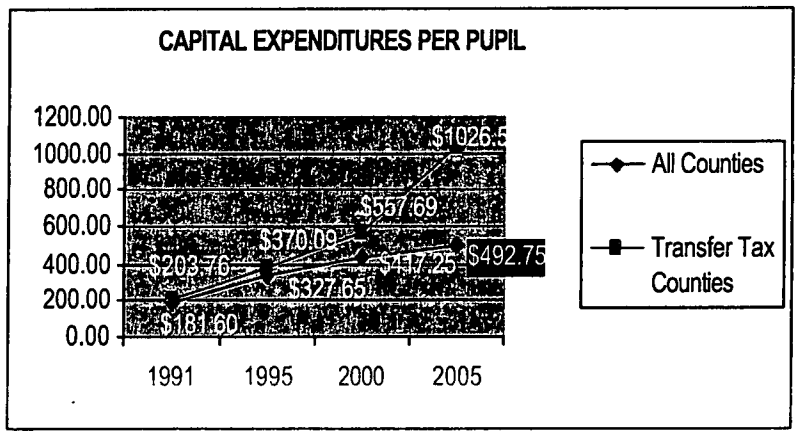
If not for the Land Transfer Tax, we would fall further behind in our school capital needs and would have to raise our property tax. We have been able to build a middle school and renovate two elementary schools without incurring any debt

Dan Scanlon, Currituck County Manager

SCHOOLS

In each case, the land transfer tax has completely changed how taxpayers fund public schools. These initiatives have increased the capital expenditures to public schools tremendously.

The tax has guaranteed each district a minimum level of per-pupil funding. From 1990 to 2005, increases in capital expenditures per pupil by these counties has outpaced the state average. From 1995 to 2000, these counties increased their expenditures by 33 percent as compared to only a 21 percent increase by counties as a whole. Over the next five years, these counties increased their per pupil expenditures dramatically, whereas expenditures generally leveled off for all other districts.



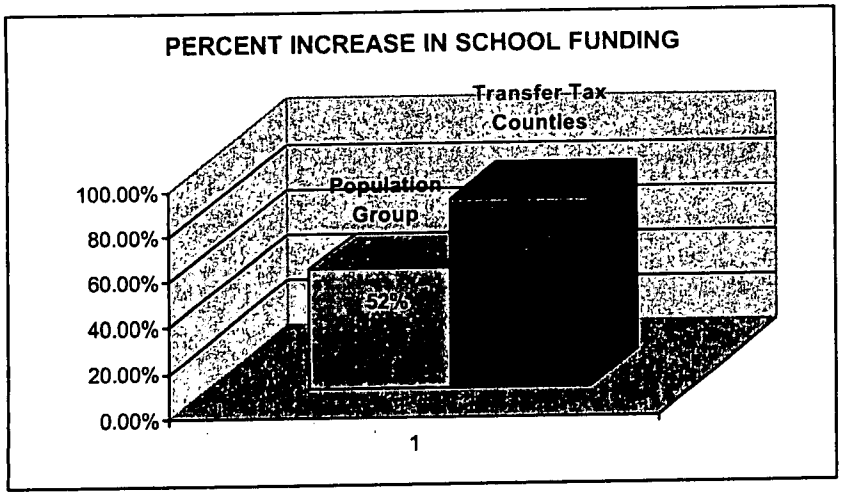
NC ASSOCIATION OF COUNTY COMMISSIONERS

In 1985, prior to implementing the land transfer tax, all of these counties ranked in the bottom third of the rankings with respect to the amount of funds expended on public education. By comparison, Washington County ranked 87th in 1995 and still ranks 86th for the 2006-07 fiscal year in per capita capital expenditures. Had Washington County received voter approval, they likely would have been able to increase their expenditures and thereby their ranking in the state.

For 2006-07, four of the six transfer tax counties ranked in the top five in outlays for school capital expenditures per capita (see chart). These counties have consistently outranked similarly sized counties since instituting the tax. Pasquotank and Chowan rank in the top third of all counties, despite their small school system status.

All six of those counties rank among the top 45 in the state in county education spending per pupil based on 2006-07 budgets. Dare leads the way, budgeting more than $7,600 per student. Currituck is seventh, Perquimans is 18th, Pasquotank is 28th, Chowan is 35th and Camden is 45th.

The five-year moving average for public school capital expenditures pre-transfer tax for Camden, Currituck, Chowan and Dare counties was $59,668. Post-transfer tax, the five-year average increased to



$791,381. Adjusted for inflation this represents an 84 percent increase compared to a 52 percent increase for comparably sized counties. For Pasquotank and Perquimans, the trend is similar.

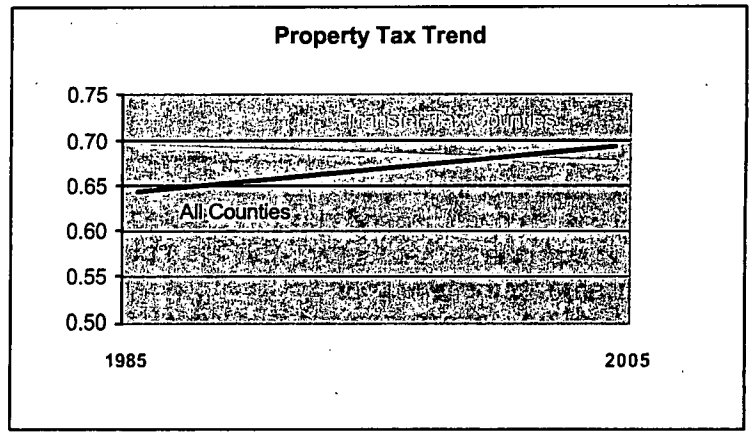
Overall, the land transfer tax has helped reduce funding disparities between property-rich/urban districts and property-poor/rural districts in these areas. In 1991, local per pupil capital expenditures ranged from $56 to $239. Today, per pupil capital funding has significantly moved upward with these districts allocating between $438 and $2,135 per pupil this school year.

Dare	$3,879.86
Perquimans	$1,500.26
Orange	$1,350.43
Transylvania	$1,188.92
Watauga	$1,186.58
Union	$1,156.93
Camden	$1,151.17
Currituck	$1,134.64
Jackson	$1,132.45
Carteret	$1,119.08
Mitchell	$1,087.87
Brunswick	$1,047.55
Polk	$1,041.78
Wake	$981.88
Alleghany	$960.10
Avery	$953.73
New Hanover	$931.00
Johnston	$926.16
Lincoln	$919.28
Macon	$886.98
Cabarrus	$833.16
Pender	$827.34
Henderson	$793.31
Cherokee	$785.32
Davie	$781.50
Iredell	$781.44
Mecklenburg	$741.19
Durham	$727.36
Buncombe	$709.01
Pasquotank	$701.24
Surry	$672.20
Catawba	$665.92
Granville	$654.88
Jones	$641.66
Rutherford	$628.74
Chowan	$596.30
Franklin	$581.04
Pamlico	$549.58
Chatham	$538.51
Forsyth	$529.95
Guilford	$524.78
Randolph	$517.15
Ashe	$503.86
Tyrrell	$495.62
Lee	$486.05
Person	$483.04
Northampton	$469.39
Onslow	$468.90
Hyde	$468.74
Wilson	$463.80
Sampson	$451.89
Bladen	$450.73
Moore	$429.80
Caswell	$421.44
Alexander	$413.60
Halifax	$412.27
Burke	$410.25
Stanly	$400.38
Harnett	$396.83
Beaufort	$395.69
Swain	$395.32
Gates	$389.70
Gaston	$387.20
Richmond	$383.35
Bertie	$380.11
Pitt	$368.42
Rowan	$367.47
Warren	$359.52
McDowell	$354.64
Rockingham	$353.00
Anson	$347.92
Stokes	$346.30
Davidson	$341.88
Graham	$337.76
Lenoir	$329.26
Scotland	$316.33
Montgomery	$314.78
Washington	$308.23
Cleveland	$305.29
Alamance	$301.46
Yadkin	$300.00
Hertford	$297.06
Wilkes	$294.25
Columbus	$287.42
Greene	$286.16
Haywood	$285.93
Craven	$281.03
Vance	$278.79
Duplin	$277.80
Yancey	$272.37
Hoke	$267.01
Martin	$258.48
Robeson	$254.40
Madison	$248.18
Wayne	$242.10
Clay	$241.95
Edgecombe	$226.34
Nash	$203.18
Caldwell	$197.86
Cumberland	$174.34

Consequently, local school districts have had greater flexibility in how and where they allocate their funds. Local school officials have been empowered to establish funding priorities according to local needs rather than state-level mandates.

IMPACT ON PROPERTY TAXES

Ideally, with the imposition of a new tax, a local tax structure should reflect balance such that the total burden on taxpayers remains fair. These counties have generally provided their citizens with significant property tax relief. Taken as a whole, property taxes prior to the referendum were an average of .67 cents per hundred for these counties. Once each of these counties levied the tax, property tax rates stood at an average of 63 cents per $100 for the group (in 1991). Most importantly, comparing these counties to similarly sized counties reveals that they were able to *cut* taxes by six percent during this time period (1985-1991), whereas, their comparison group collectively raised taxes 7 percent. Since 1991, the statewide trend in property taxes has been upward; however, for these counties the property tax has demonstrated a downward trend. In 1991, effective tax rates ranged from a low of .44 to .70 per $100. For fiscal year 2006-07, effective tax rates range from .21 to .54 for these six counties. Undoubtedly, long-term residents of these counties realized significant savings.



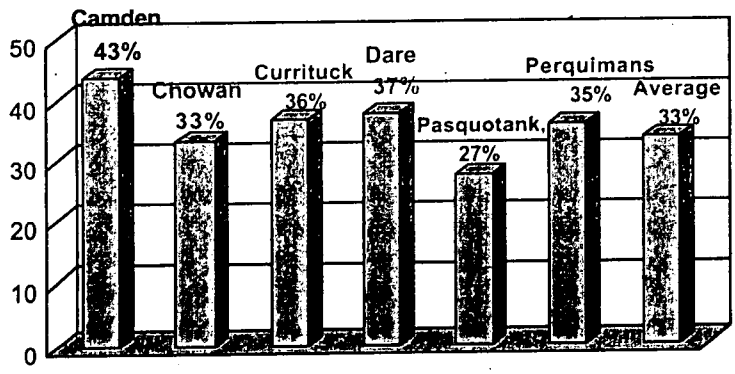
A closer examination of the total tax burden for each of the counties shows that there is some variability. Compared to the states' 100 counties, four of the six rank in the middle third at 39th, 48th, 55th, 68th , with the remaining two ranked in the top five. It must be noted, however, that the relatively high rankings of Dare and Currituck counties (first and fourth, respectively) reflect the nature of their populations, which include high numbers of seasonal residents with luxury homes. Their income is not included in this analysis but the local taxes they pay are included, skewing the comparison with counties who do not have many seasonal residents. Taken as a whole, these numbers demonstrate that there is no direct correlation between land transfer taxes and property taxes; that is, for the most part counties have achieved a balance in the overall tax structure despite the levying of the additional tax.

HUMAN CAPITAL & ECONOMIC DEVELOPMENT

The subject of land transfer taxes invariably leads to a question of how these measures impact economic development. According to figures from the N.C. Department of the Treasury, five years following the enactments, this group of counties increased contributions to Economic Development activities by an average of 55 percent. Comparing this to the performance of similarly sized counties reveals that their average increase in any comparable time period was only 25 percent.

These investments were made across a range of areas consistent with the diversity we see in the economies of this region. Nonetheless, the manufacturing base of these counties is relatively low, as each depends upon a growing service sector and some are reliant on a bustling tourist oriented economy. With this industry configuration in mind, we examine per capita income for the time period of 1991 to 2000, and see that five of the six counties met or exceeded the average increase in income for the entire state. They have been able to

PERCENT INCREASE IN PER CAPITA INCOME 91'-00'



literally weather the storm as their economies are highly influenced by the incidence of severe weather events. Nonetheless, the unemployment rate for each of these counties in 2005 was lower than the state average. Moreover, historically, the labor market in this region has consistently performed better than counties of comparable size. So too, if we compare this region to another similarly sized tourist-oriented economy (Mid Carolina

Council — Buncombe, Henderson, Transylvania and Madison counties) we find that these counties have consistently exhibited lower unemployment rates. Therefore, the land transfer tax shows no ill effects on employment rates or economic growth.

Economic growth (as measured by gross retail sales per capita) shows that some counties have fared better than others. Dare and Currituck both ranked in the top five with respect to growth in this measure during the 1990s (ranking fifth and second, respectively). However, the remaining four counties rank as follows: Camden (29), Pasquotank (52); Chowan (73) and Pasquotank (97).

HOMEOWNERSHIP AND POPULATION GROWTH

According to the 2000 census, the median home value in four of the six counties was below the state average. In the case of Chowan, Perquimans and Pasquotank counties, the values were approximately 78 percent of the state average value of $108,300. Camden County's values were five percent lower than the state average.

Currituck and Dare counties had values that exceeded the state average, principally due to an increase in the number of high-cost seasonal and retirement homes.

> We've averaged almost 30% annual growth the last 4 years. We are issuing about double the amount of dwelling permits now than we were just a few years ago.
>
> *Bobby Darden, Perquimans County Manager*

MEDIAN HOME VALUES
US Census Bureau

Currituck	115,500
Camden	113,000
Chowan	85,000
Dare	137,000
Pasquotank	85,000
Perquimans	83,000

The region has also continued to see population growth. Projections from the NC State Demographer show that this area is projected to grow by 33 percent over the next 25 years. During the 15 years (1986-2000) after the implementation of the transfer tax, the area experienced double-digit growth of 22 percent. Moreover, while every county surrounding this group lost population between 2000 to 2004, each of these counties experienced a population increase.

Because of these positive indicators, this region has enjoyed a healthy economic picture for quite some time. The presence of consistently strong growth in the tax base, moderate debt levels, a low tax rate and the ability to fund essential projects has allowed each of these counties to achieve moderate to high bond ratings. If any instability can be found it would be in the economic concentration in tourism and the vulnerability of the region to major storms. However, these counties have demonstrated financial flexibility and solid reserves to mitigate these concerns.

CONCLUSION

Adhering to the three Guiding Principles has allowed these counties to contend with the challenges of growth while simultaneously exhibiting sound fiscal stewardship.

1. Taxpayer Protection through Tax Limitation
2. Focus on Continued Economic Development
3. Maintain cognizance of total tax picture

It is evident that North Carolina's experience with the land transfer tax shows this is a valuable tool for counties. Because the revenues are targeted to infrastructure development and because officials have adhered to the principles above, concerns that transfer taxes inhibit growth, lead to skyrocketing home prices and unduly burden homeowners can be allayed.

A balanced approach to taxation clearly benefits elderly citizens and those on fixed incomes by lessening the pressure on property taxes. This allows these citizens to remain in their homes without fear of losing them to increasing tax rates or tax values.

From the perspective of the individual taxpayer (whose ability to pay taxes is entirely related to his/her own economic well-being), the volatility of property tax rates is equally problematic. Forcing counties to rely primarily on property taxes poses a challenge, because property taxes are levied on citizens regardless of their ability to pay. Whether they have a job or live on a fixed income, the levy is applied. Transfer taxes, however, are paid during the real estate transaction when citizens typically have financing available.

Finally, some argue that the land transfer tax is a volatile and fluctuating revenue source and that linking capital projects like schools to such a source is problematic. However, as demonstrated, the use of conservative budgeting with economically sensitive revenues and maintaining adequate fund balances for capital and disaster recovery insulates the financial stability from these fluctuations. It is evident these counties remain attractive and affordable places to live.

North Carolina Tax Reform: Fairness and Other Considerations

Institute on Taxation and Economic Policy
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www.itepnet.org
April 16, 2007

Discussion Topics

- ITEP's tax model– how it works, what it's good for
- State tax fairness: nationwide perspective
- Other tax reform principles
- Thoughts on subcommittee recommendations
- Lessons from other states

About ITEP

- Founded in 1980
- ITEP's research focuses primarily on state tax issues, with an emphasis on tax fairness and adequacy.
- In the past decade, we've conducted studies of state tax systems in Arkansas, Illinois, Iowa, Minnesota and New York.
- We've also conducted hundreds of smaller-scale tax analyses in over 40 states.
- What makes us useful: **ITEP Microsimulation Tax Model.**

The ITEP Tax Model-What it Does

- Predicts the distributional effect of proposed tax changes on taxpayers at different income levels
- Predicts the overall revenue gain (or loss) from proposed changes
- Estimates the overall state and local tax burden in each of the 50 states and Washington, DC
- Measures the interaction between state and federal tax changes (how state tax changes affect federal taxes paid, and how federal "tax mandates" affect the states)

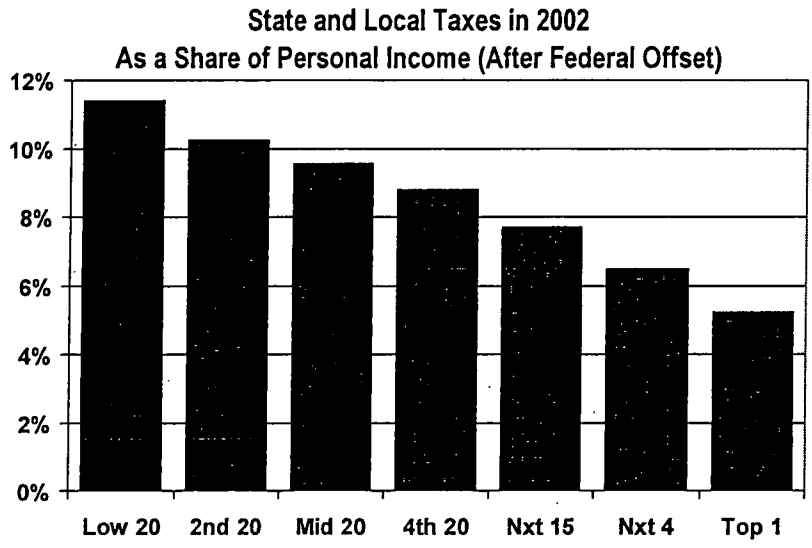
The ITEP Tax Model-How it Works

- Based on a sample of 750,000 federal tax returns, allows a statistically valid sample for all 50 states and D.C.
- Income data from these returns is "matched" with Consumer Expenditure Survey, Census Bureau, and other data to estimate property, sales and excise tax burdens for any year from 1988 to 2012.
- This "matching" process allows us to estimate the impact of proposed changes in sales, income, and property taxes in each state—and to estimate the impact of "tax swaps" involving more than one of these tax bases simultaneously.
- The use of federal tax data allows us to estimate the effect of state tax changes on federal taxes—and vice versa.

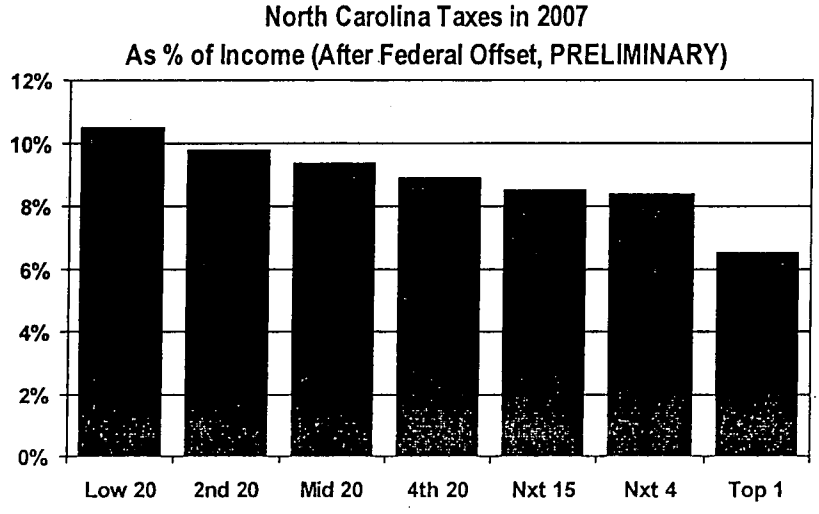
Principles for a 21st Century Tax System

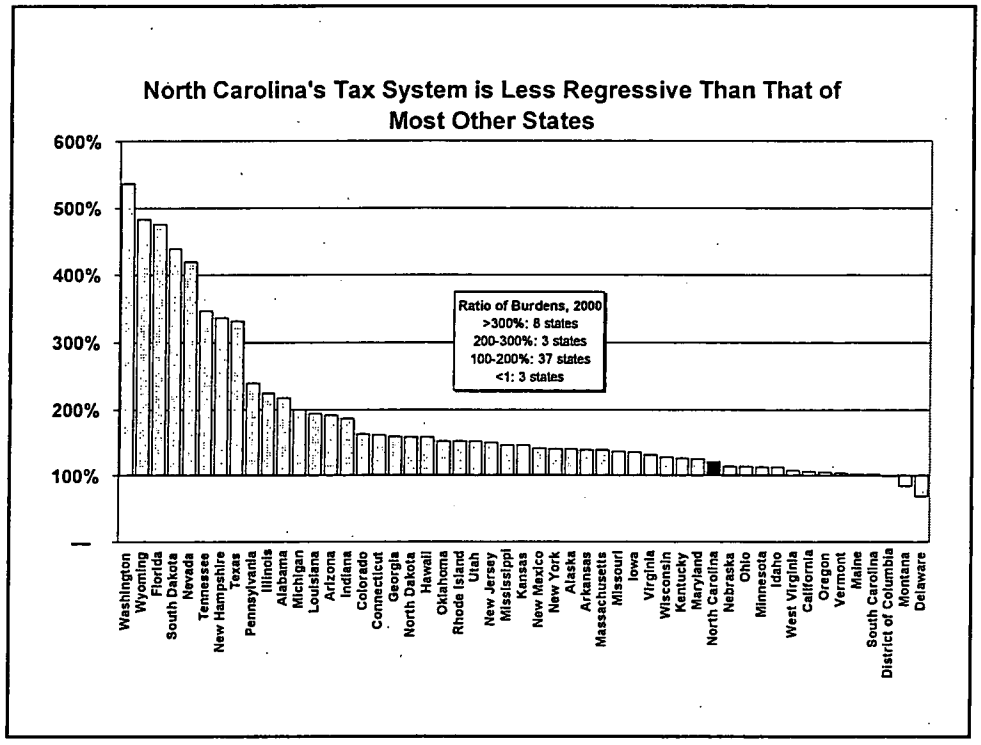
- **Fairness**: Vertical and horizontal equity
- **Base-broadening** (broad base = low rate)
- **Adequacy**– short-term *and* long-term
- **Simplicity**
- **Economic Development** Impact
- **Neutrality**
- Exportability

State and local taxes are regressive nationwide...

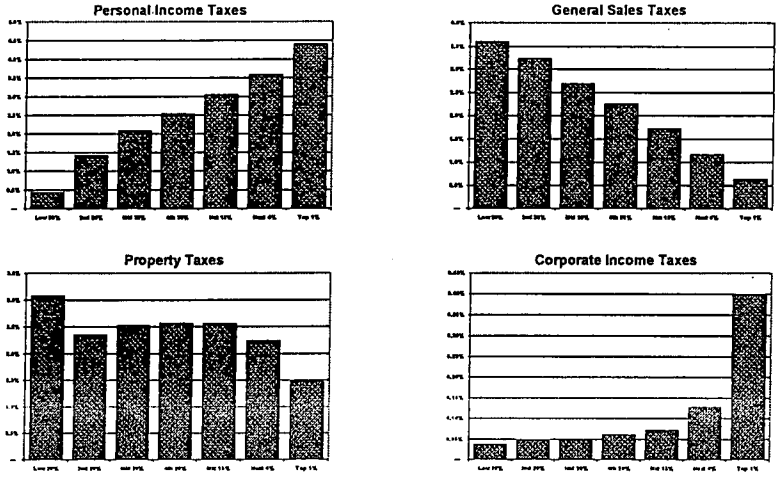


North Carolina's Tax System is Regressive Too

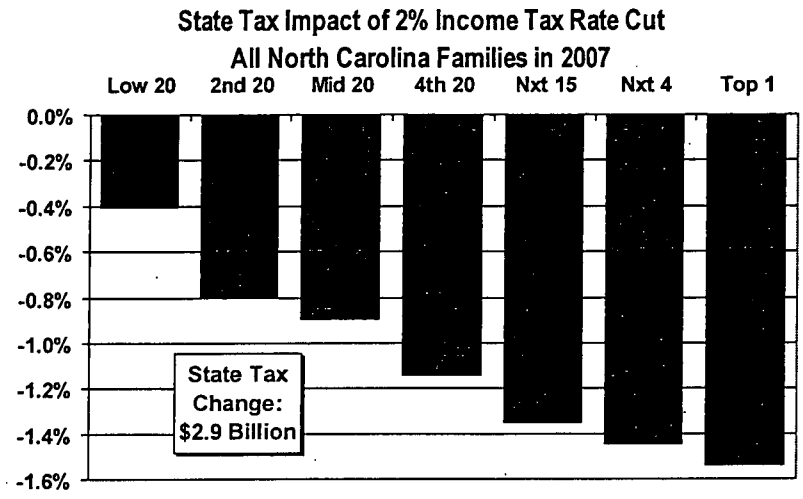




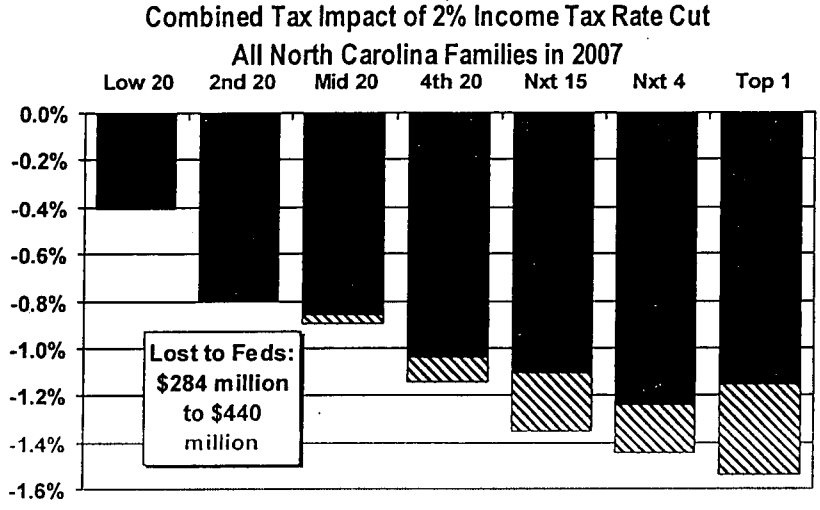
Building blocks of tax equity: progressive, proportional, regressive taxes.



"Across the Board" Income Tax Rate Cuts Would, Taken On Their Own, Make North Carolina's Tax System More Regressive



But between 10 and 15 percent of this tax cut would never see the inside of Tarheels' wallets.

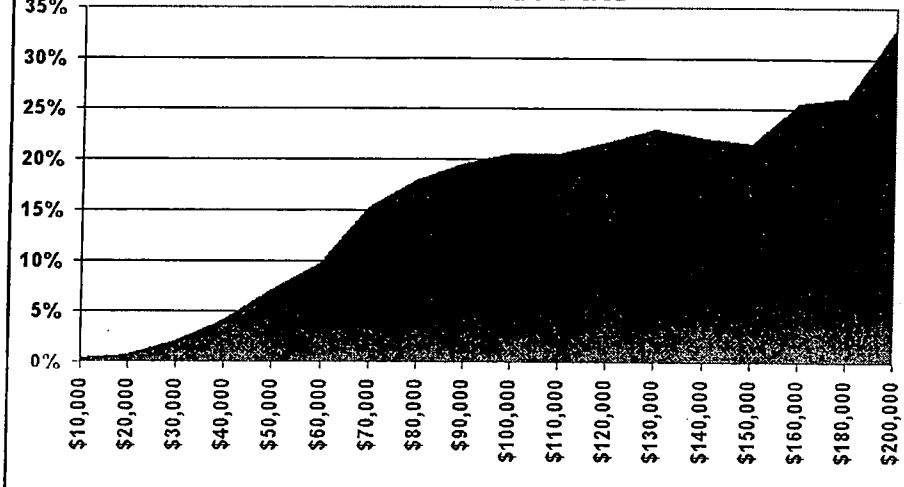


The "Federal Offset": A Closer Look

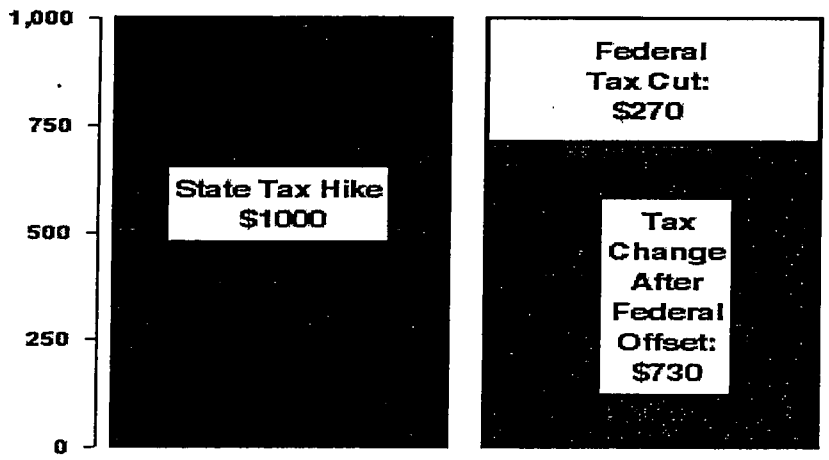
- North Carolina families who itemize their federal income taxes can write off their state income taxes.
- This is also true of property taxes and (temporarily) sales taxes, but only the income tax is targeted to federal itemizers who pay at high federal rates.
- The federal alternative minimum tax affects the federal offset because AMT taxpayers have this itemized deduction disallowed.
- Federal offset estimate varies depending on what you assume about federal AMT reform: under current law, offset is $284 million (10% of state tax cut). Under 2006 AMT exemptions, offset is $440 million (15%)

Lesson #1: Federally deductible taxes are a good deal. Cutting them is a bad deal.

% of State Income Tax Hikes Offset By Federal Tax Cuts

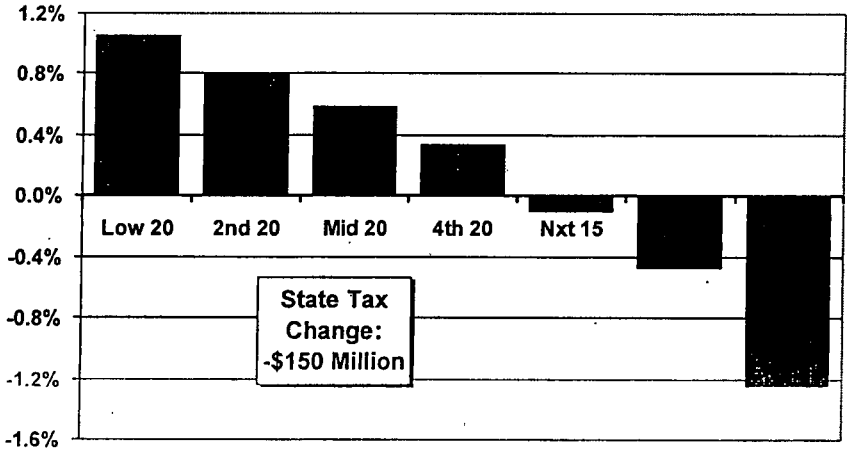


Lesson #2: federally deductible taxes are never as burdensome as they seem.

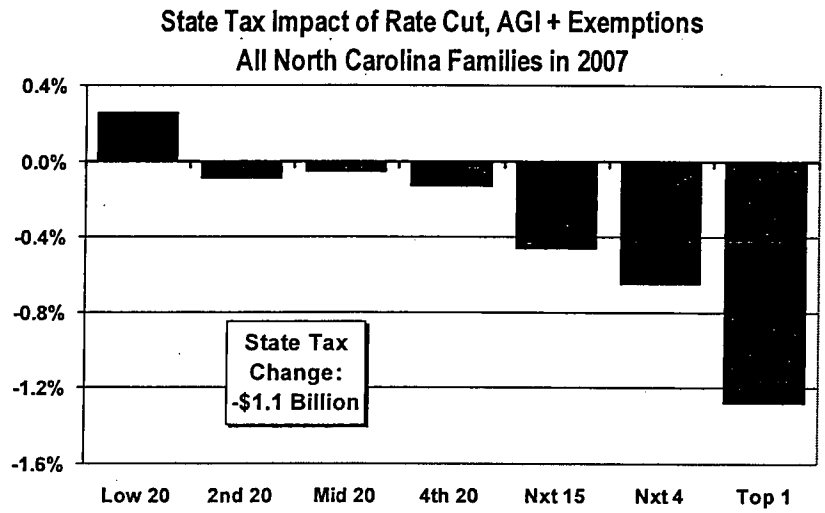


Combining Rate Cuts With a Broader Base, Take 1:
Base= Slightly Modified Federal AGI
Poorest 80% of Income Distribution Sees a Tax Hike

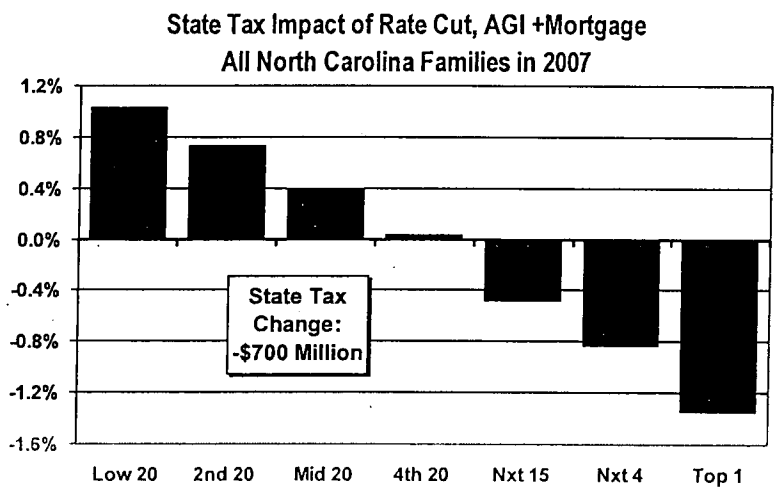
State Tax Impact of Rate Cut, AGI Base
All North Carolina Families in 2007



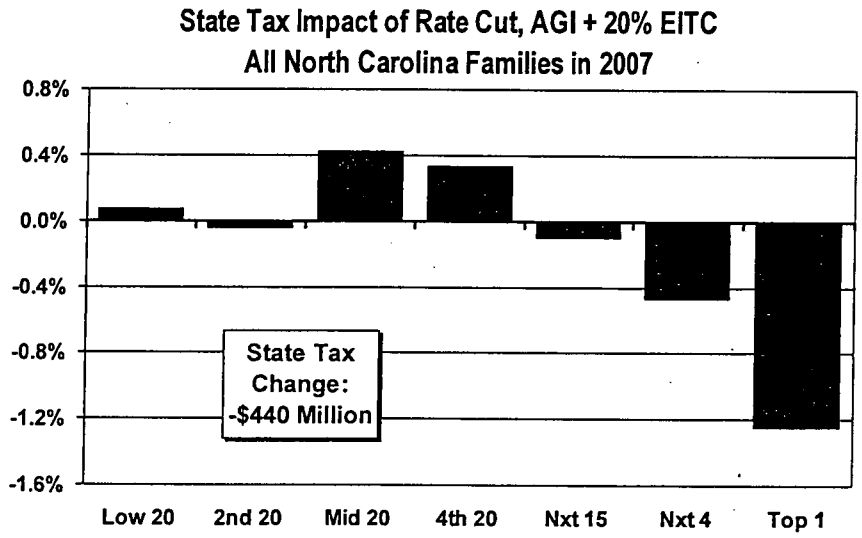
Combining Rate Cuts With a Broader Base, Take 2:
Base= Federal AGI Minus Exemptions
Poorest 20% of Income Distribution Sees a Tax Hike



Combining Rate Cuts With a Broader Base, Take 3:
Base= Federal AGI Minus Mortgage Deduction
Poorest 80% of Income Distribution Sees a Tax Hike



Combining Rate Cuts With a Broader Base, Take 3:
Base= Federal AGI; 20% EITC Allowed
Poorest 80% of Income Distribution Sees a Tax Hike



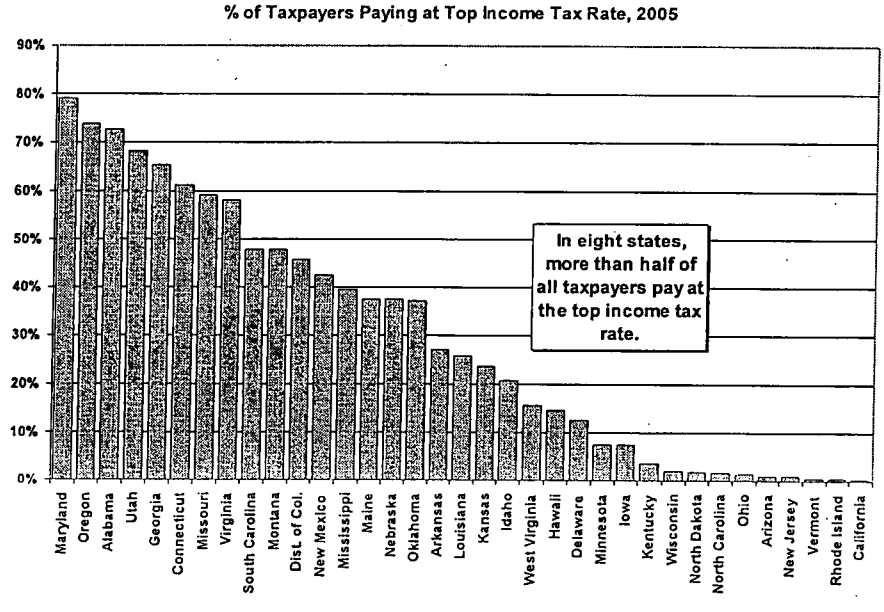
Fairness = Adequacy

- Potential impact of closing the fairness gap:
- If lawmakers changed the tax system to require that the wealthiest 1% should pay as much of their income as the poorest 20%, the revenue yield would be **$589 million** in 2006.
- Requiring the top 5% to pay as much as the poorest 20%: **$1.07 billion**.
- Impose same condition on top 20%: **$1.6 billion**.
- Simple reason: top 20% has 57% of the income; poorest 20% has 3.6% of the income statewide.

What about Income Tax Volatility?

- Opponents of income tax hikes argue that states with heavy income tax reliance are susceptible to fiscal shortfalls when capital gains decline. But...
- The good times can be really good. (Google stock options responsible for 1/8 of $4 billion income tax growth in California last year.)
- Revenues can be put in Rainy Day Funds in growth periods to get through bad times.
- Temporary rather than permanent tax cuts in good times leave base intact in bad times

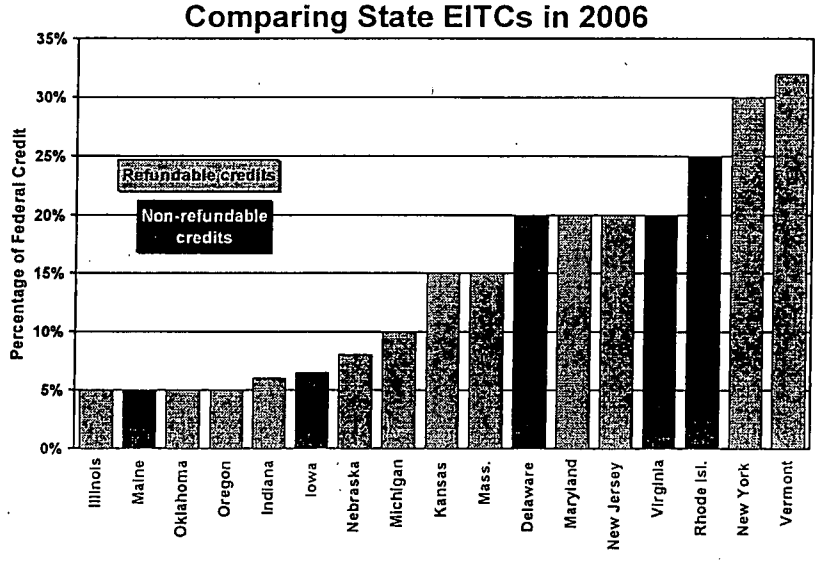
Many state income taxes are "graduated" in name only.



Elderly income tax breaks are usually poorly targeted—and carry a high long-term price tag.

- Many elderly tax breaks benefit pensioners while providing no benefit to wage-earners.
- Most pension tax breaks have no income limits, (Minnesota, Oregon, Virginia impose limits) and some have especially high caps.
- Social Security benefits are completely exempt in most states.
- Rapidly aging population (12.4% over 65 in 2000, almost 20% by 2030) means cost of these breaks will grow rapidly.
- **Poorly-targeted income tax breaks for seniors are a ticking time bomb.**

20 states now have EITC's: but only some are refundable, and some are redundant.

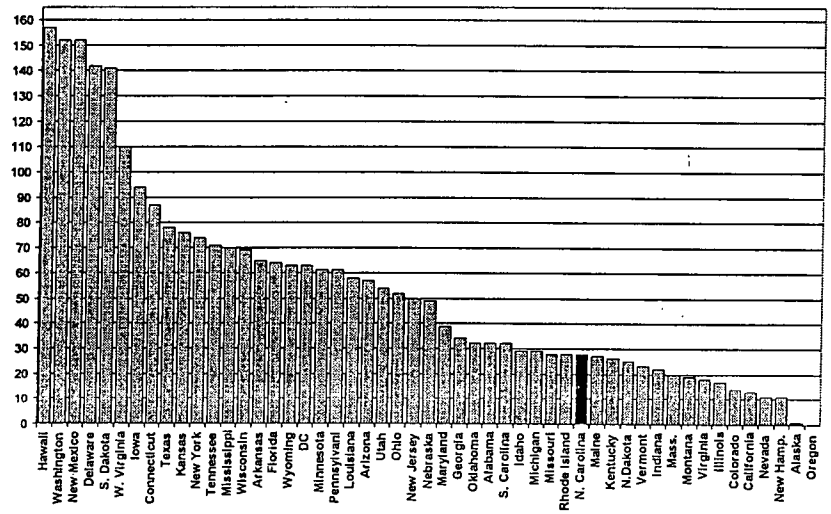


The sales tax: a regressive, but necessary tool for sustainable tax reform

- The most regressive major tax
- *Generally* not deductible on federal income tax returns
- North Carolina exempts many goods and services.
- Services are growing as a share of consumption, while goods are declining– so North Carolina's sales tax is leaking fast.

FTA survey: most states tax less than half of available services.

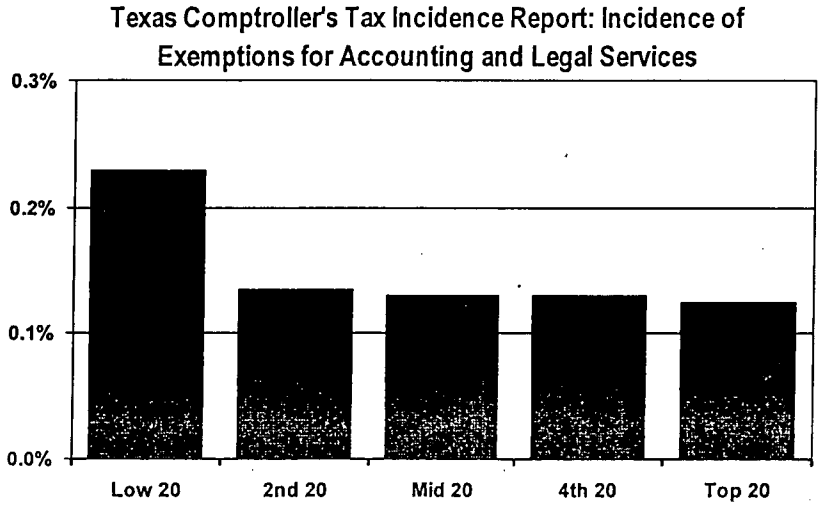
Sales Taxation of Services, 1996



Will Taxing Services Make North Carolina's Sales Tax (More) Progressive?

- Taxing personal services is clearly much less regressive than the current base.
- Taxing some "luxury services" may even be slightly progressive.
- But any substantial base expansion will include services consumed at all income levels– which means comprehensive base expansion is unlikely to make the sales tax much less regressive.
- Taxing business services will likely lead to exporting part of incidence– but in-state portion likely to be regressive.

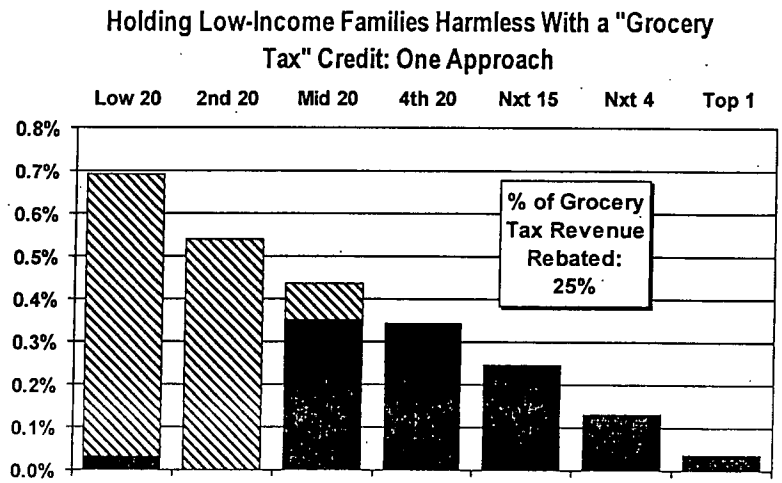
The best state-specific tax incidence model suggests that taxing business services won't be a progressive move.



What About Exempting Groceries. Clothing, Utilities?

- Undeniably a progressive tax cut.
- Cutting the food tax is not a partisan issue.
- But it's expensive. Food can be 10 to 20% of a state's sales tax base.
- If it turns out to be unaffordable, long-term impact can be bad for low-income families
- Cheaper alternatives are available.

A "hold-harmless" sales tax credit is a costly proposition.



Sales tax credits can deliver targeted, low-income sales tax relief at a lower cost than exemptions.

The Kansas Food Sales Tax Refund

Only taxpayers over 55, taxpayers with children under 18, and disabled taxpayers are eligible.

Income Level	Refund
$0 to $12,500	$60 per exemption
$12,501 to $25,000	$30 per exemption
$25,001 or more	no refund

Combined Reporting is the Obvious Corporate Tax Reform Solution– But Disclosure Matters Too

- The SEC requires publicly held corporations to disclose basic information about their federal income tax payments.
- Thanks to these reporting requirements, we know that many of the largest and most profitable corporations have been able to reduce or zero out their tax liability—and we have some ideas about how.
- Most states impose little or no reporting requirements on corporations' state taxes.

Information is Power

- **Disclosure** of corporate tax payments and tax breaks is the gold standard in tax transparency.
- Regular **tax incidence analysis** reminds lawmakers that fairness is lacking.
- **Tax expenditure reports.** Lawmakers (and the public) should know where the money is going.

Summing Up: Strategies for a Sustainable and Fair State Tax System

- **Personal income tax:** the gold standard for tax fairness (and sustainability). Allow low-income credits like the EITC.
- **Corporate income tax:** Better disclosure of tax information.
- **Sales taxes:** Do it right: broad base, low-income credits.

Tax Changes in the States, 2002-2007: Noteworthy legislation

- >25 states increased cigarette taxes
- Massachusetts repealed a capital gains break– and New Mexico created one.
- Major property tax cuts (ID, NE, SC).
- Strengthening corporate income tax (NJ, NY,TX)
- Cutting sales tax on food (NM,UT,WY,SC, WV).
- Income tax rate cuts
- Decoupling from federal tax breaks.
- Continued expansion of EITC

Takeaway Points:

- Fairness-enhancing tax reform can help achieve other worthy tax goals, especially adequacy.
- Income tax cuts are a bad deal for North Carolina– and economic benefits are hard to measure.
- Base-broadening is an important goal, and can be more politically palatable than rate hikes.
- Transparency is an important goal too.
- Recognize the difference between short-term and long-term solutions.
- Taxes and spending are two sides of the same coin.

State Tax Fairness Resources:

- Weekly "Tax Justice Digest." Best and worst of state (and federal) tax politics and policy. Sign up by emailing ctj@ctj.org
- Our tax policy weblog: www.talkingtaxes.org.
- Our website: www.itepnet.org.
- Center on Budget and Policy Priorities (www.cbpp.org).

Program Responsibilities and Infrastructure Recommendations

In ranking the specific recommendations shown below, the following general principles are understood:

(1). Needs should be assessed and provided at the lowest possible level of government consistent with economies of scale and other efficiency concerns.
(2). Local functions should be paid for by locally controlled and collected revenue sources and state functions and state mandated functions should be paid for by state controlled and collected revenue sources.
(3). Funding formulas should be driven by need or other factors closely associated with the provision of the service.
(4). Every citizen in North Carolina should be assured of receiving uniform and sufficient opportunities for essential services.
(5). North Carolina and local governments should use debt conservatively and follow the State's debt affordability guidelines.
(6). Any shift from local governments to state government (and vice versa) for funding responsibility must include a swap of revenue authority.
(7). Public infrastructure should be financed by those who benefit most directly from the capital investment.

Recommendations:

(Rank from 1 to 8 in terms of priority where 1 should be the highest priority item and 8 should be the lowest priority).

___ The State should assume responsibility for the county share of Medicaid.

___ The State should develop and implement wellness programs in order to control the long-term costs of Medicaid and consider other options such as Medicaid HMOs, "fees" for smoking, expanding pay for performance programs and linking benchmark care standards (to be developed by the Governor's office) to reimbursement rates.

___ The State should take over funding responsibilities for local election personnel or shift authority for local election personnel to local governments.

___ Where appropriate, tolls roads and public/private partnerships may be used to finance transportation projects and increase the speed of completion. Proxies for the use of roads and highways such as the gas tax and highway use tax should remain the prevailing source of revenues for these purposes.

___ Local governments should be given flexibility to use Powell Bill funds for projects on state roads.

___ The State should issue bonds to replace the 1998 Clean Water Bonds. Funds from these bonds should be allocated to local utilities that have the greatest need and should be used to provide incentives to regionalize or otherwise provide more cost effective services.

___ Local governments should assess user rates to cover both capital and operational costs of providing water and sewer infrastructure.

___ The State should provide greater flexibility for the use of local tax revenue by lifting some mandates that earmark revenues.

Tax Related Recommendations

In ranking the specific recommendations shown below, the following general principles are understood:

(1). Overall changes in the tax system should be revenue-neutral.
(2). The tax system should be equitable and fair resulting in similarly situated taxpayers being taxed similarly and similar transactions being taxed in the same manner.
(3). The tax system should be as simple as possible, thereby reducing compliance burdens on taxpayers and administrative burdens on government.
(4). The tax system should provide the government with a sufficient and predictable source of revenue without having to resort to rate increases.
(5). The tax system should be efficient and not impede or reduce the productive capacity of the economy.
(6). The tax system should be competitive with other states in order to promote long-term sustainable economic development, job creation and growth.

Recommendations:

(Rank from 1 to 14 in terms of priority where 1 should be the highest priority item and 14 should be the lowest priority)

___ Reduce the top marginal individual income tax rate to a rate that is competitive with other southeastern states.

___ Broaden the individual income tax base to federal adjusted gross income with minimal deductions and exemptions.

___ Reduce the number of individual income taxpayers by eliminating the filing requirement of those with immaterial taxable income and who pay an insignificant amount of income tax.

___ Reduce the corporate income tax rate to a rate that is competitive with other southeastern states.

___ Broaden the corporate income tax base by enacting a combined reporting regime for related entities and conduct a comprehensive review of the corporate franchise tax in order to alleviate any possible compliance burdens as a result of two corporate tax reporting systems.

___ Repeal the estate and gift taxes.

___ Reduce North Carolina's reliance on the individual income tax

___ Broaden the sales tax base to include services in a revenue neutral manner and lower the sales tax rate.

___ Eliminate differential rates in the sales tax as well as sales tax exemptions (including the food exemption). Some mechanism should be provided to relieve lower income households from any additional tax burden.

___ Move all excise taxes to an ad-valorem basis.

___ Include privilege taxes as sales/use taxes or eliminate them.

___ Give local governments greater flexibility with respect to how they raise revenue to fund the services they provide. A menu of taxes and fees should be available to local governments and should be consistent across the state. The menu should include but not be limited to: options for sales taxes, real estate transfer fees or deed stamp taxes, impact fees, motor vehicle license taxes and vehicle use fees.

___ Reduce reliance on the gas tax and use alternative proxies for road use such as an increased vehicle sales tax, motor vehicle license tax, or mileage based fees that would lead to additional resources for transportation infrastructure.

___ Give local governments options to provide property tax deferrals for elderly or fixed income residents and to revalue property using annual indexing.

Subcommittee Recommendations

Recommendations of the Income Tax Subcommittee

In addition to the general tax principles agreed to by the Commission, the Income Tax Subcommittee adopted the additional principle that "the tax system should be competitive with other states in order to promote long-term, sustainable economic development, job creation and growth.

(1). Reduce the top marginal individual income tax rate to a rate that is competitive with other southeastern states.

(2). Broaden the individual income tax base to federal adjusted gross income with minimal deductions and exemptions.

(3). Reduce the number of individual income taxpayers by eliminating the filing requirement of those with immaterial taxable income and who pay an insignificant amount of income tax.

(4). Reduce the corporate income tax rate to a rate that is competitive with other southeastern states.

(5). Broaden the corporate income tax base by enacting a combined reporting regime for related entities.

(6). Conduct a comprehensive review of the corporate franchise tax in conjunction with recommendation number 5 in order to alleviate any possible compliance burdens as a result of two corporate tax reporting systems.

(7). Repeal the estate and gift taxes.

(8). Reduce North Carolina's reliance on the individual income tax.

Recommendations of the Sales and Excise Tax Subcommittee

(1). Broaden the sales tax base to include services in a revenue neutral manner and lower the sales tax rate.

(2). North Carolina should eliminate differential rates in the sales tax as well as sales tax exemptions (including the food exemption). Some mechanism should be provided to relieve lower income households from any additional tax burden.

(3). Move all excise taxes to an ad-valorem basis.

(4). Include privilege taxes as sales/use taxes or eliminate them.

Recommendations of the Local Tax Subcommittee

(1) Give local governments greater flexibility with respect to how they raise revenue to fund the services they provide. A menu of taxes and fees should be available to local governments and should be consistent across the state. The menu should include but not be limited to: options for sales taxes, real estate transfer fees, impact fees and vehicle use fees.

(2). The State should provide greater flexibility for the use of local tax revenue by lifting some mandates that earmark revenues.

(3). Sales taxes should be broadened to include services (same as Sales and Excise Tax Subcommittee Recommendation #1)

(4). Local governments should be given options to provide property tax deferrals for elderly or fixed income residents and to revalue property using annual indexing.

Recommendations of the Program Responsibilities Subcommittee

(1). The State should assume responsibility for the county share of Medicaid and have access to funding sources whose growth is sufficient to pay for the expected growth in Medicaid expenditures.

(2). The State should develop and implement wellness programs in order to control the long-term costs of Medicaid and consider other options such as Medicaid HMOs, "fees" for smoking, expanding pay for performance programs and linking benchmark care standards (to be developed by the Governor's office) to reimbursement rates.

(3). The State should take over funding responsibilities for local election personnel or shift authority for local election personnel to local governments.

(4). Revenue options available to counties should be expanded (same as Local Tax Subcommittee Recommendation # 1).

Recommendations of the Infrastructure Responsibilities and Funding Subcommittee

The Subcommittee recommended that certain general principles should be followed including that the State of North Carolina and local governments should use debt conservatively and follow the State's debt affordability guidelines, that any shift from local governments to state government (and vice versa) for funding responsibility must include a swap of revenue authority, and that public infrastructure should be financed by those who benefit most directly from the capital investment.

(1). Local governments should be given additional options to finance and support local infrastructure. Options should include a local option deed stamp tax and higher motor vehicle license taxes (basically the same as Local Tax Subcommittee Recommendation # 1 and Program Responsibilities Subcommittee Recommendations #4).

(2). Where appropriate, tolls roads and public/private partnerships may be used to finance transportation projects and increase the speed of completion. Proxies for the use of roads and highways such as the gas tax and highway use tax should remain the prevailing source of revenues for these purposes.

(3). Local governments should be given flexibility to use Powell Bill funds for projects on state roads.

(4). The State should issue bonds to replace the 1998 Clean Water Bonds. Funds from these bonds should be allocated to local utilities that have the greatest need and should be used to provide incentives to regionalize or otherwise provide more cost effective services.

(5). Local governments should assess user rates to cover both capital and operational costs of providing water and sewer infrastructure.

(6). The State should consider increasing the sales tax on vehicles and weight-based registration fees.

(7). The State should consider reducing reliance on the gas tax and using alternative proxies for road use such as an increased vehicle sales tax, motor vehicle license tax, or mileage based fees that would lead to additional resources for transportation infrastructure.

North Carolina Tax Reform: Fairness and Other Considerations

Institute on Taxation and Economic Policy
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Washington, DC 20036
(202) 299-1066
www.itepnet.org
April 16, 2007

Discussion Topics

- ITEP's tax model– how it works, what it's good for
- State tax fairness: nationwide perspective
- Other tax reform principles
- Thoughts on subcommittee recommendations
- Lessons from other states

About ITEP

- Founded in 1980
- ITEP's research focuses primarily on state tax issues, with an emphasis on tax fairness and adequacy.
- In the past decade, we've conducted studies of state tax systems in Arkansas, Illinois, Iowa, Minnesota and New York.
- We've also conducted hundreds of smaller-scale tax analyses in over 40 states.
- What makes us useful: **ITEP Microsimulation Tax Model.**

The ITEP Tax Model-What it Does

- Predicts the distributional effect of proposed tax changes on taxpayers at different income levels
- Predicts the overall revenue gain (or loss) from proposed changes
- Estimates the overall state and local tax burden in each of the 50 states and Washington, DC
- Measures the interaction between state and federal tax changes (how state tax changes affect federal taxes paid, and how federal "tax mandates" affect the states)

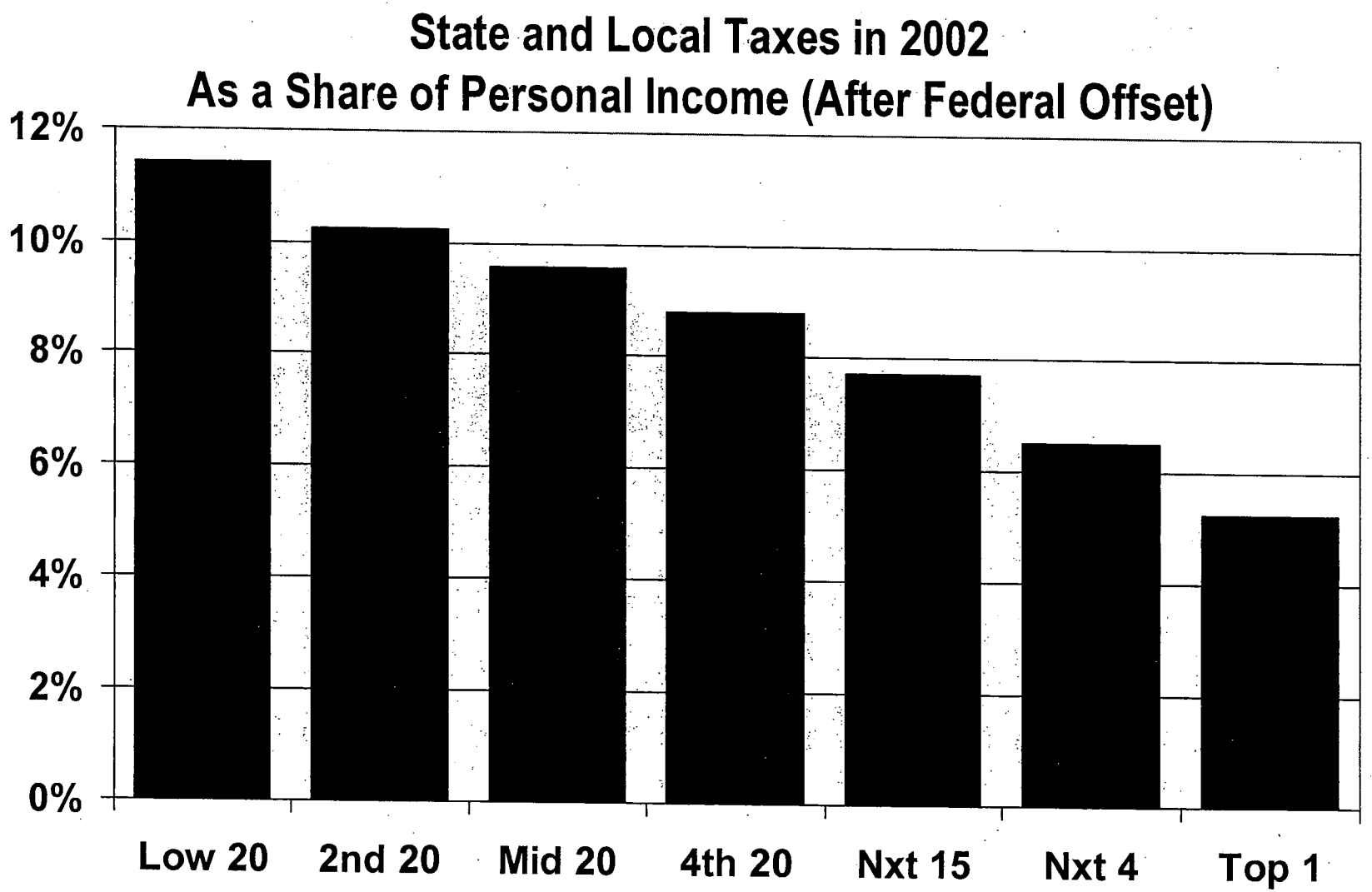
The ITEP Tax Model-How it Works

- Based on a sample of 750,000 federal tax returns, allows a statistically valid sample for all 50 states and D.C.
- Income data from these returns is "matched" with Consumer Expenditure Survey, Census Bureau, and other data to estimate property, sales and excise tax burdens for any year from 1988 to 2012.
- This "matching" process allows us to estimate the impact of proposed changes in sales, income, and property taxes in each state—and to estimate the impact of "tax swaps" involving more than one of these tax bases simultaneously.
- The use of federal tax data allows us to estimate the effect of state tax changes on federal taxes—and vice versa.

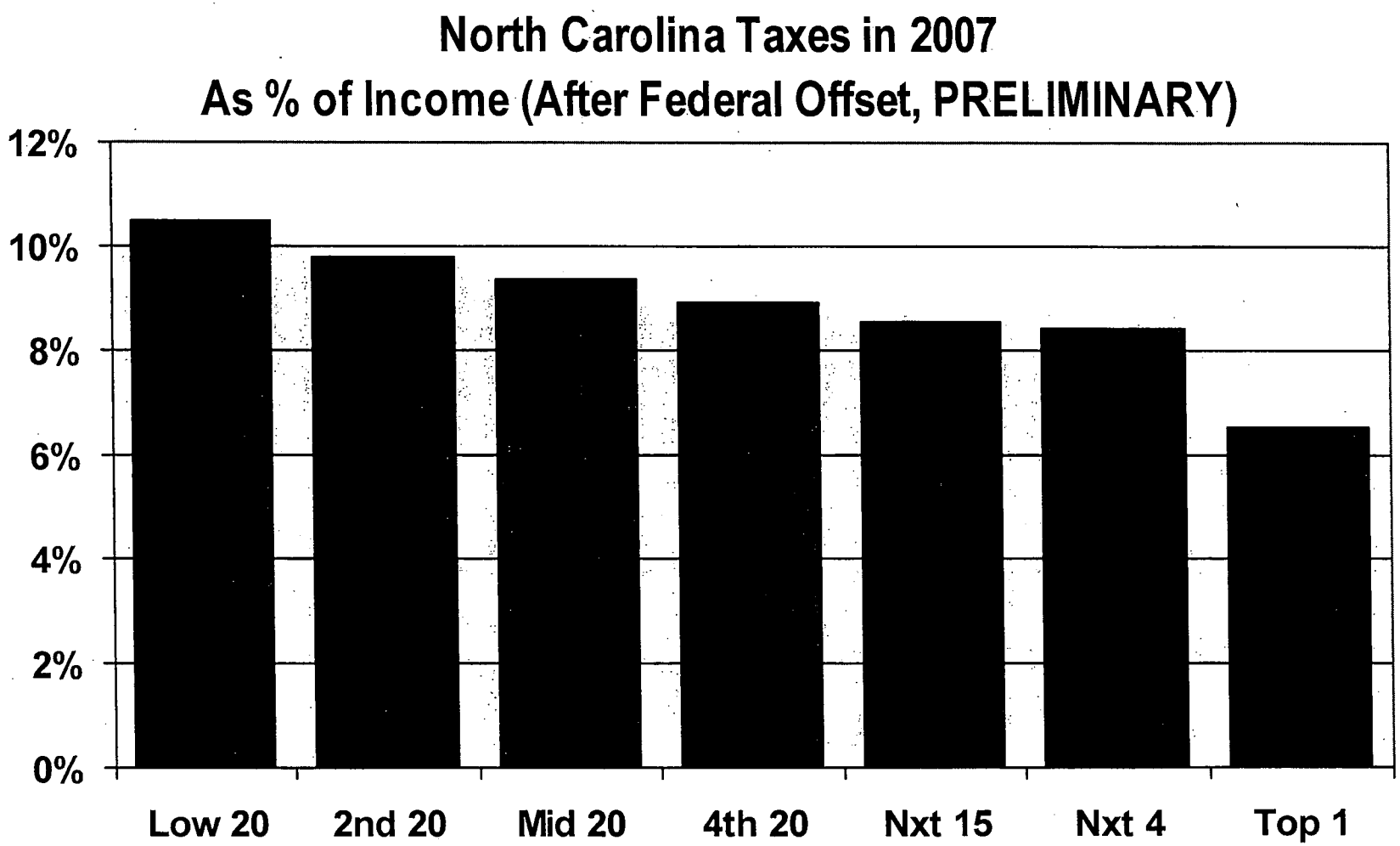
Principles for a 21st Century Tax System

- **Fairness**: Vertical and horizontal equity
- **Base-broadening** (broad base = low rate)
- **Adequacy**– short-term *and* long-term
- **Simplicity**
- **Economic Development** Impact
- **Neutrality**
- **Exportability**

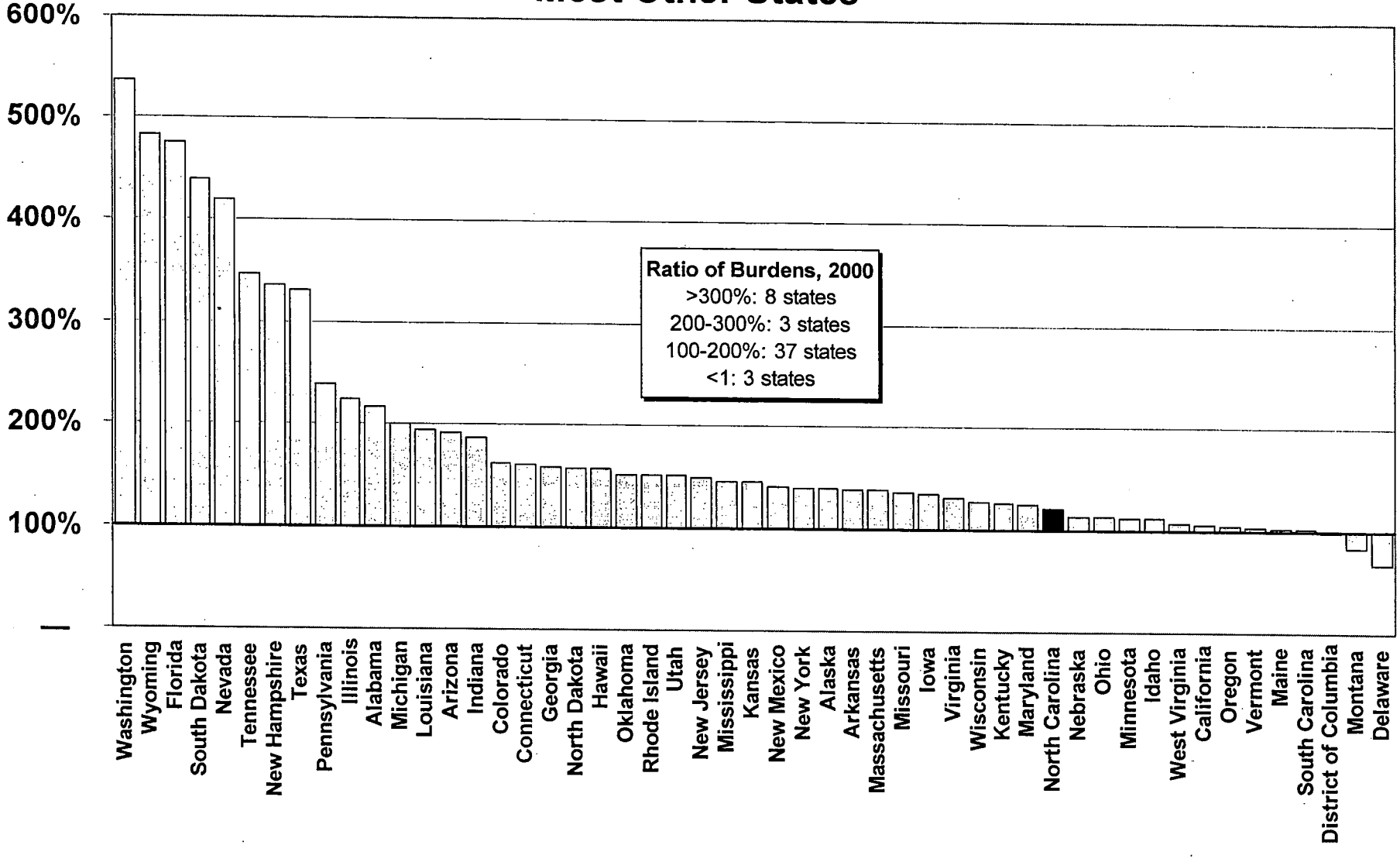
State and local taxes are regressive nationwide…



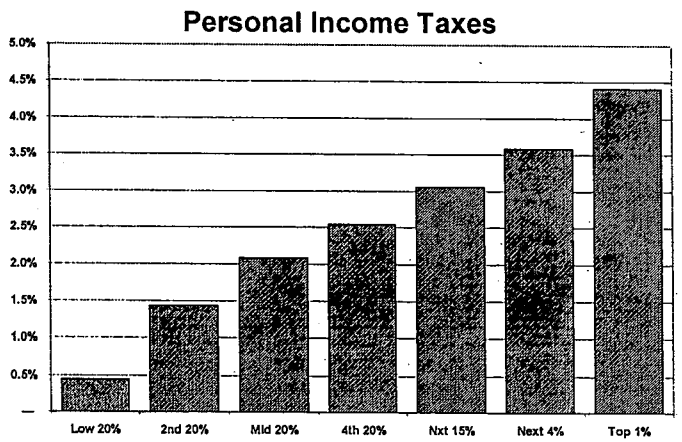
North Carolina's Tax System is Regressive Too

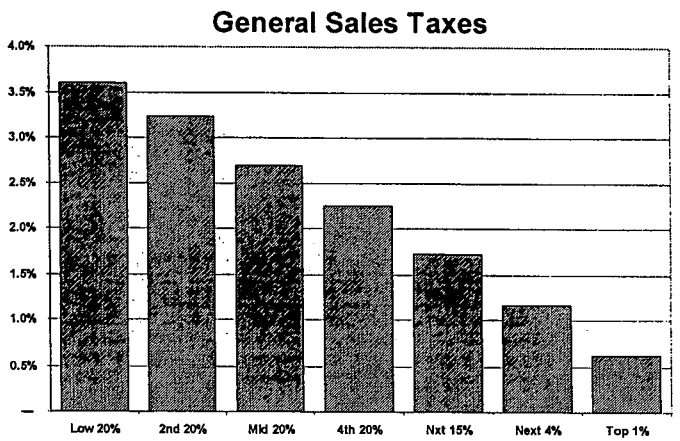


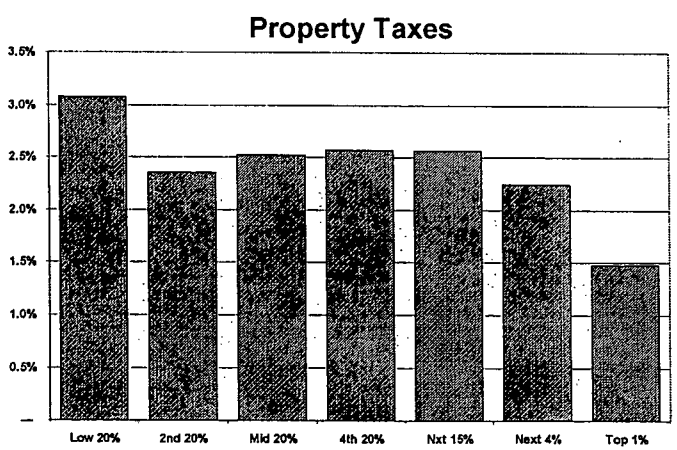
North Carolina's Tax System is Less Regressive Than That of Most Other States

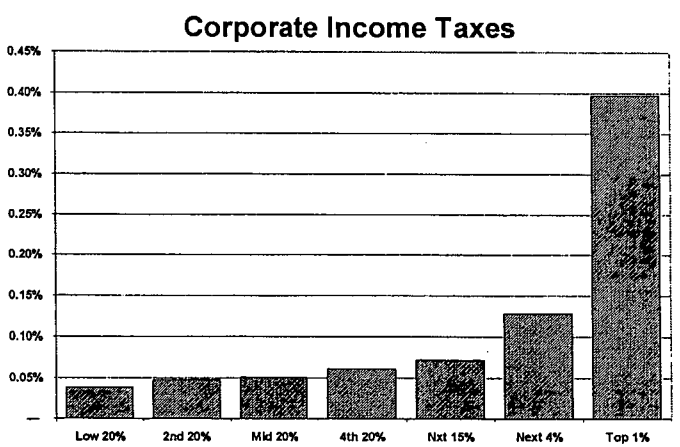


Building blocks of tax equity: progressive, proportional, regressive taxes.

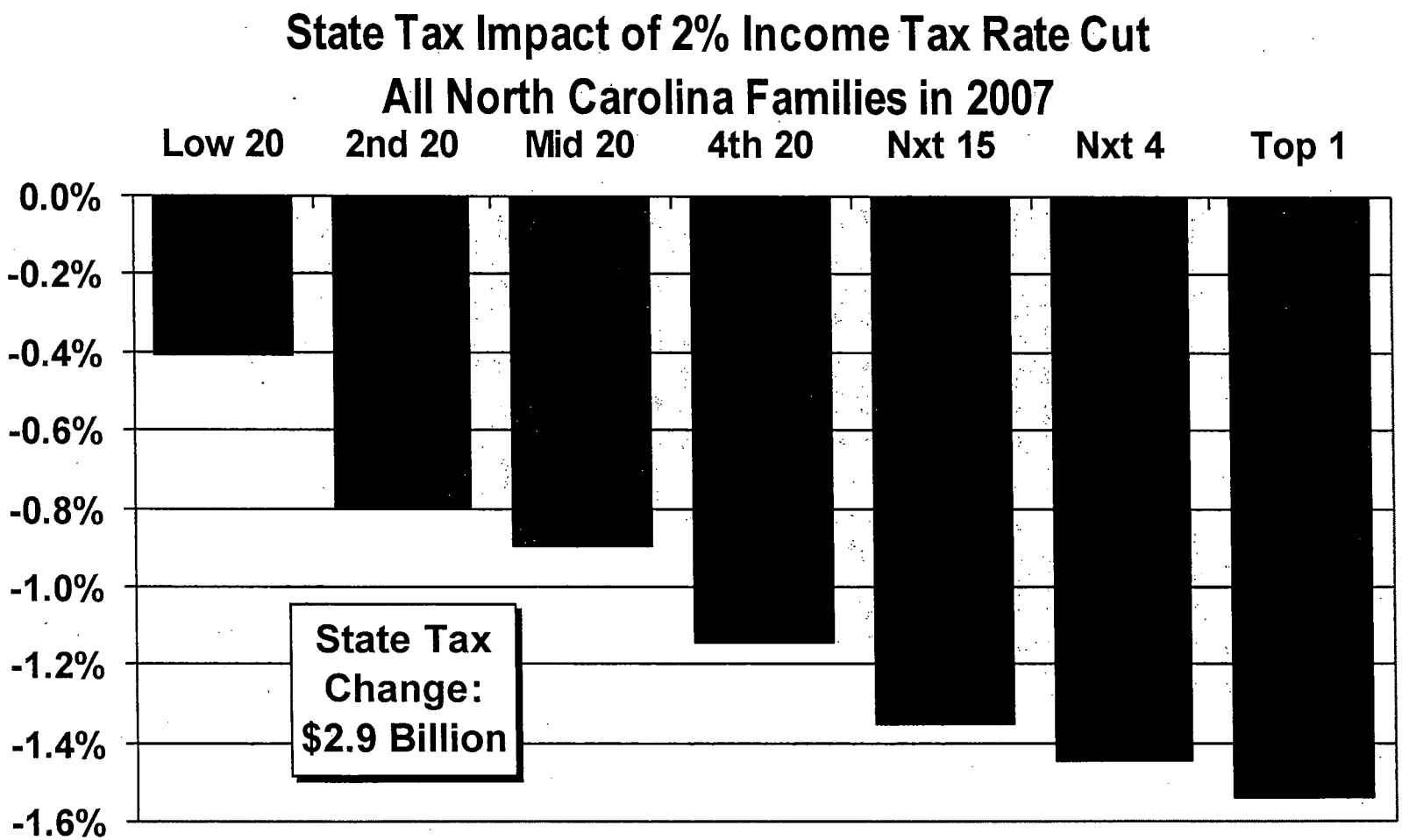




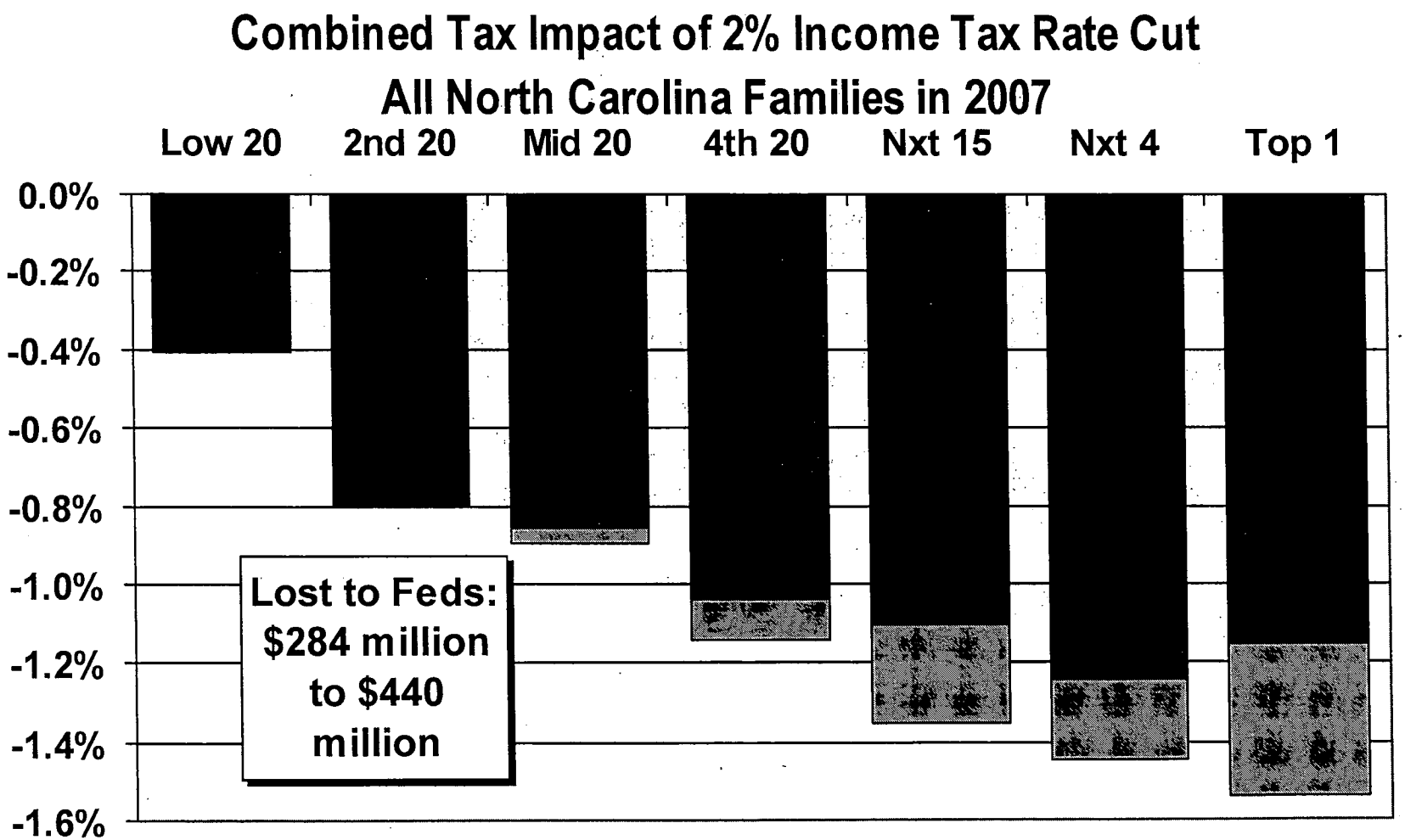




"Across the Board" Income Tax Rate Cuts Would, Taken On Their Own, Make North Carolina's Tax System More Regressive



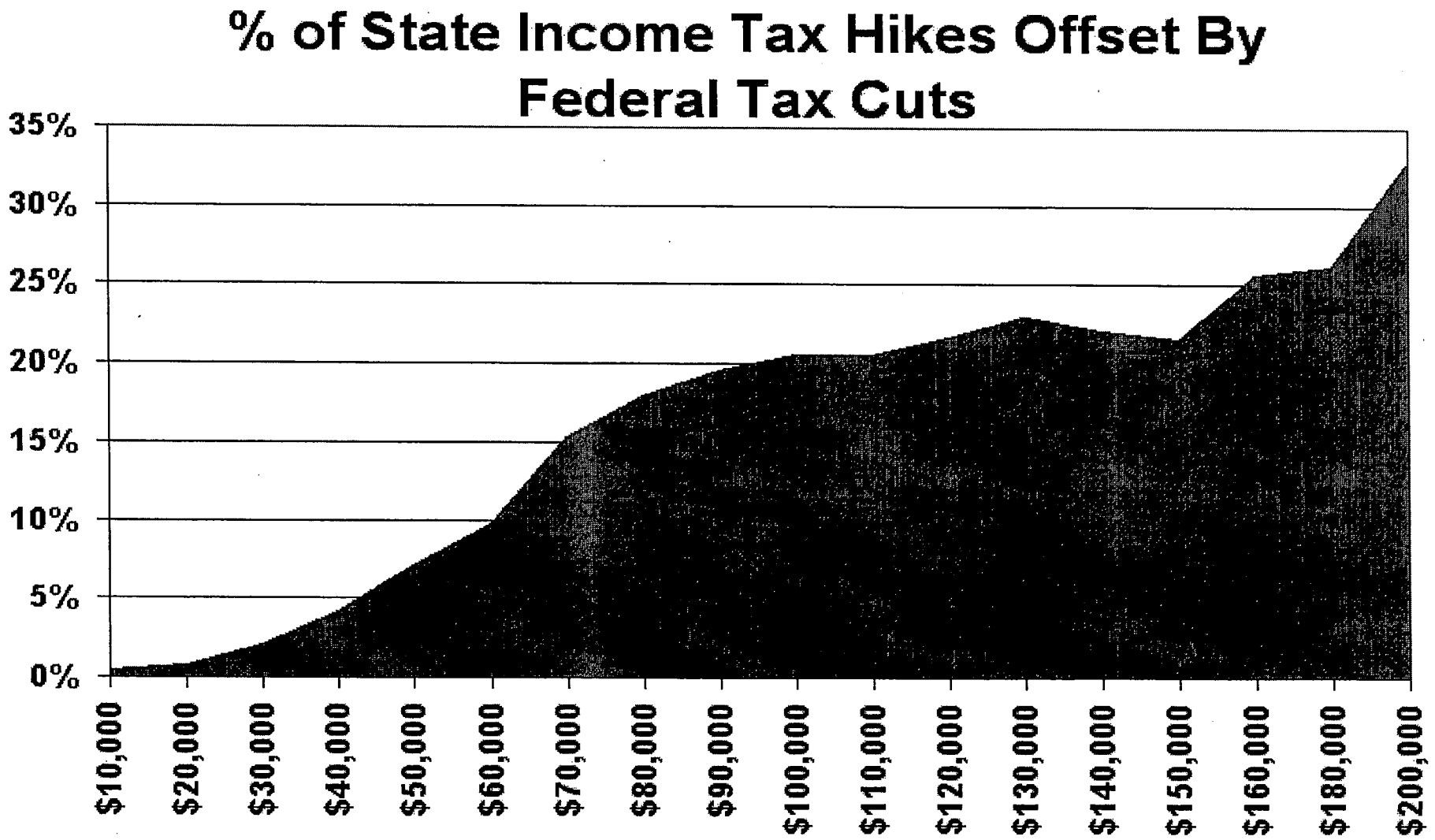
But between 10 and 15 percent of this tax cut would never see the inside of Tarheels' wallets.



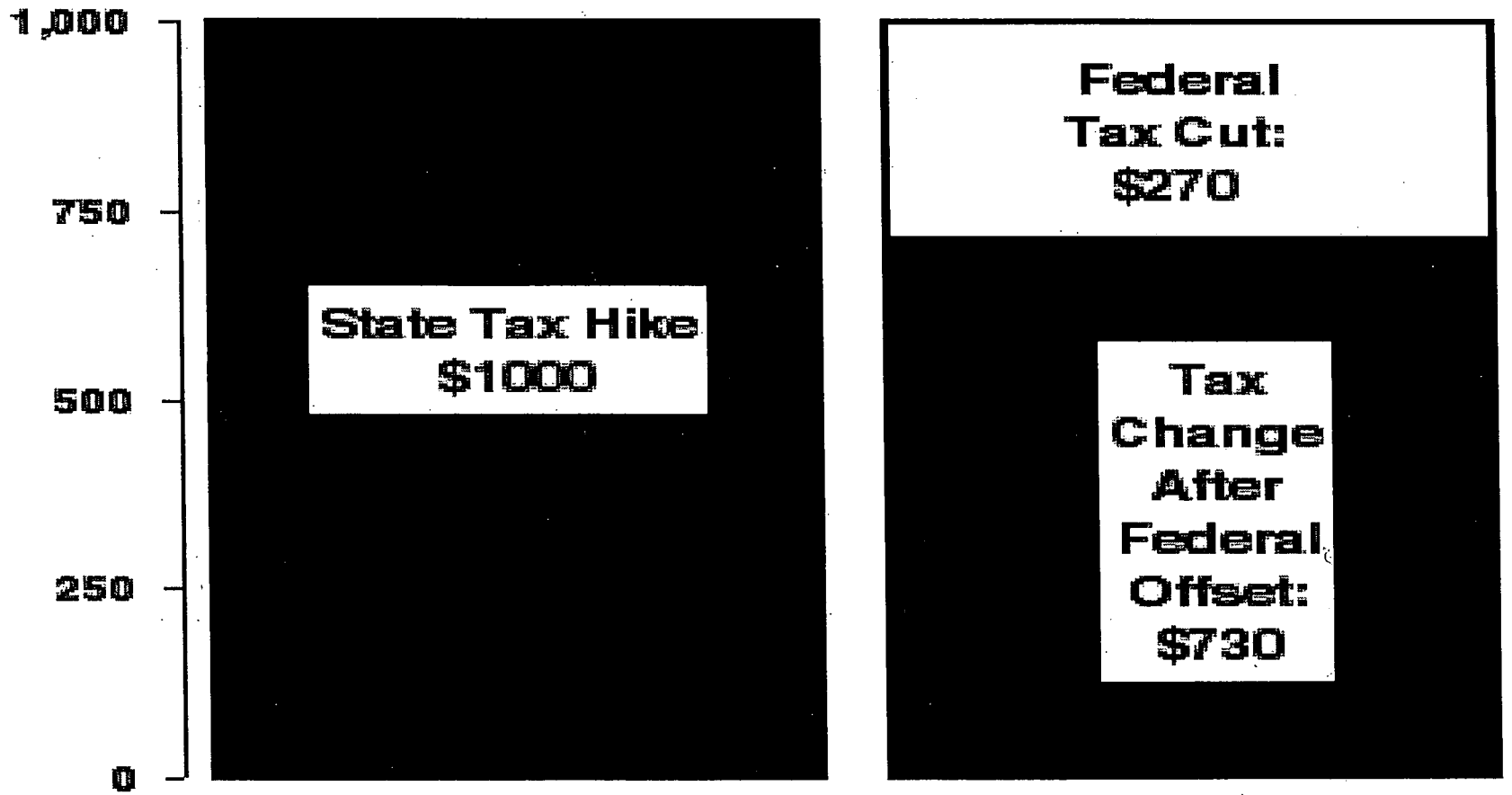
The "Federal Offset": A Closer Look

- North Carolina families who itemize their federal income taxes can write off their state income taxes.
- This is also true of property taxes and (temporarily) sales taxes, but only the income tax is targeted to federal itemizers who pay at high federal rates.
- The federal alternative minimum tax affects the federal offset because AMT taxpayers have this itemized deduction disallowed.
- Federal offset estimate varies depending on what you assume about federal AMT reform: under current law, offset is $284 million (10% of state tax cut). Under 2006 AMT exemptions, offset is $440 million (15%)

Lesson #1: Federally deductible taxes are a good deal. Cutting them is a bad deal.



Lesson #2: federally deductible taxes are never as burdensome as they seem.



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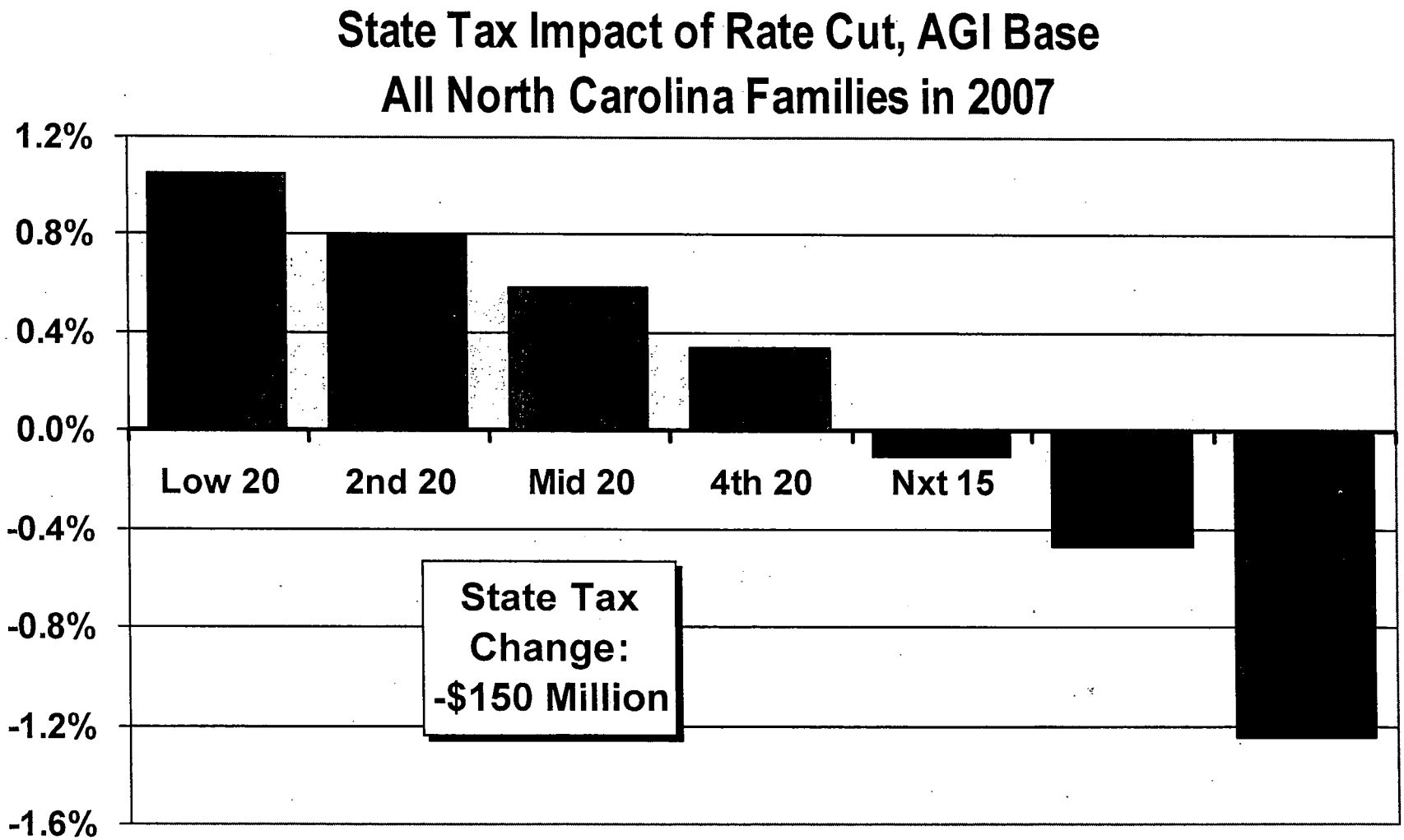

Combining Rate Cuts With a Broader Base, Take 2:
Base= Federal AGI Minus Exemptions
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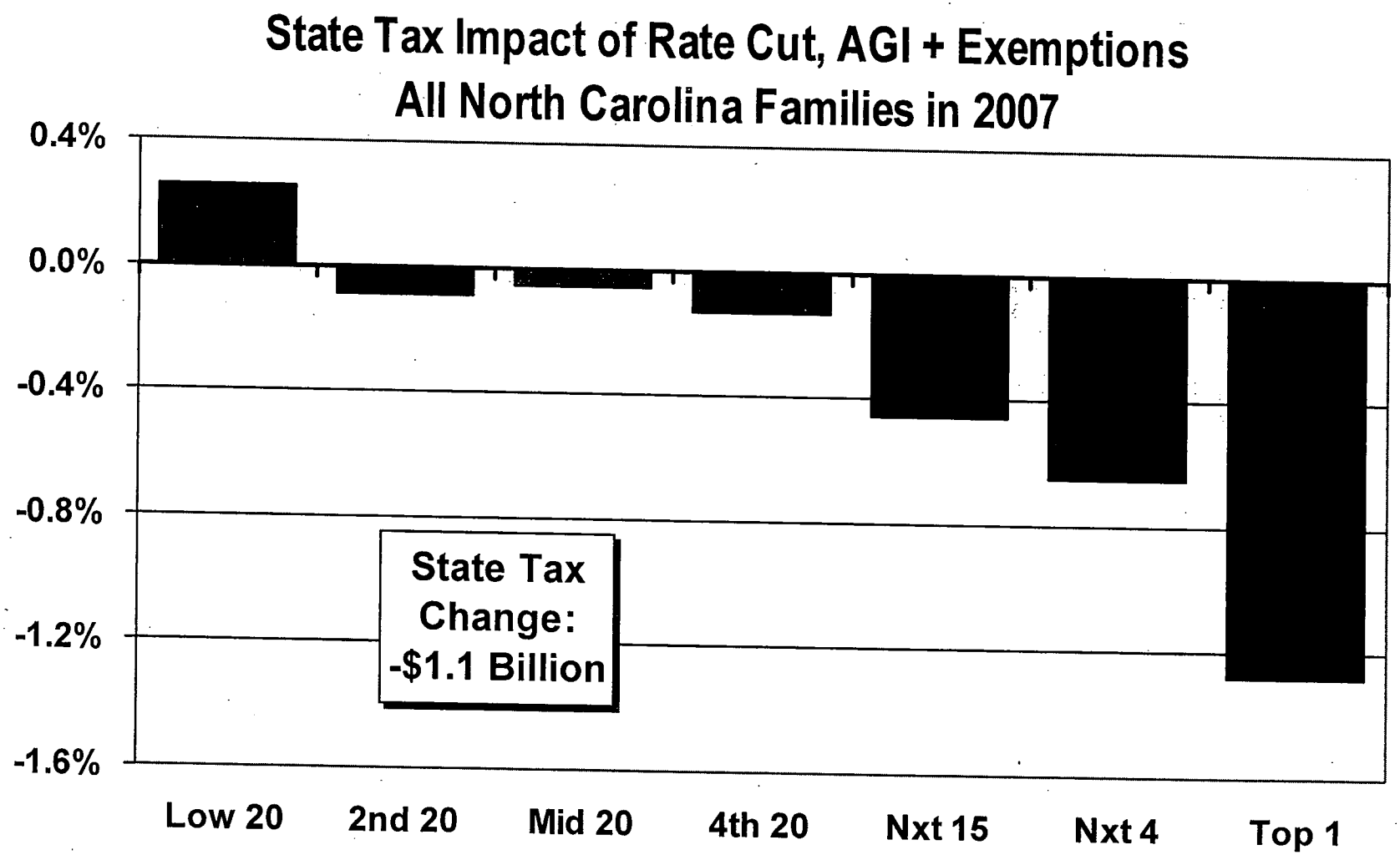

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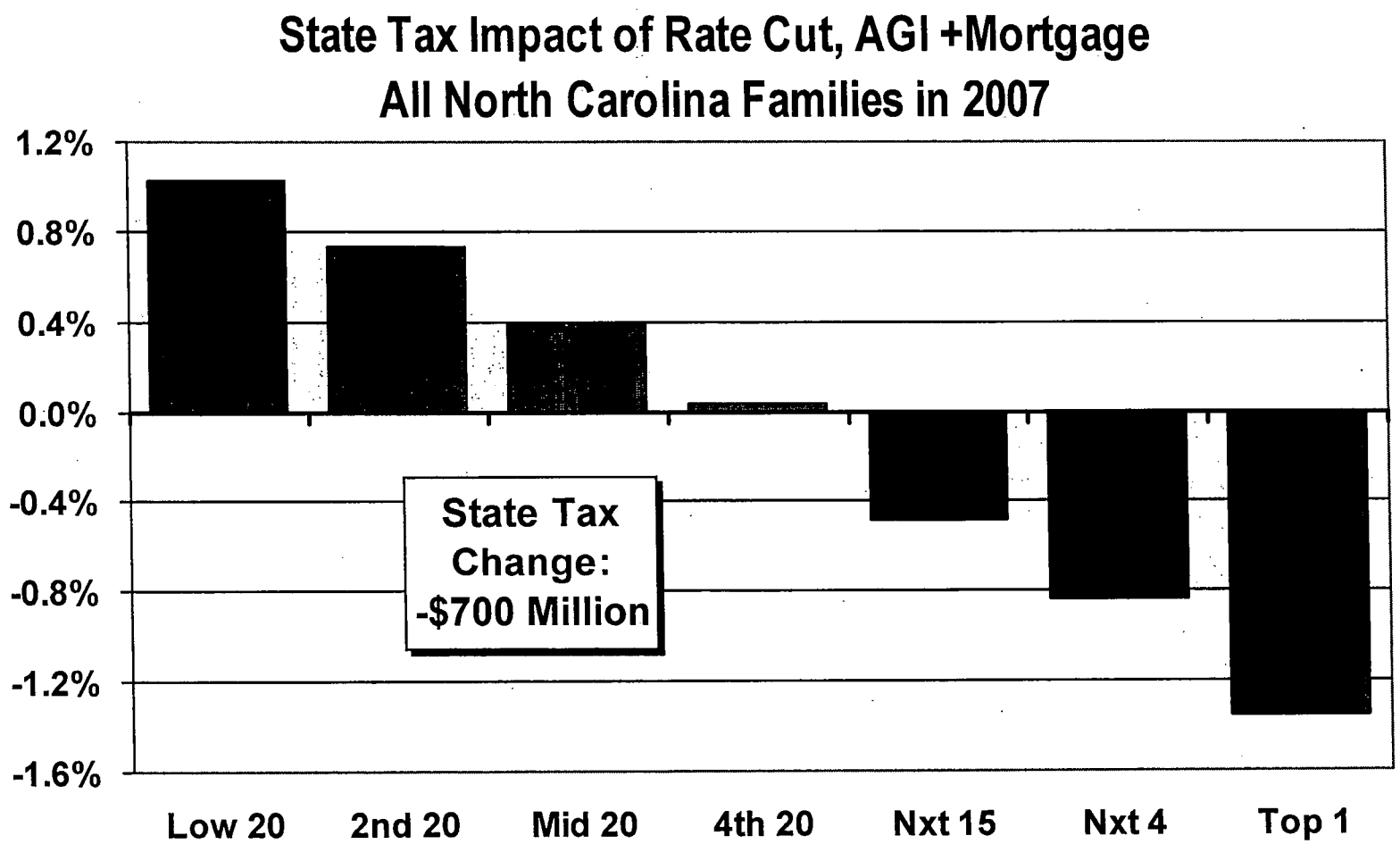

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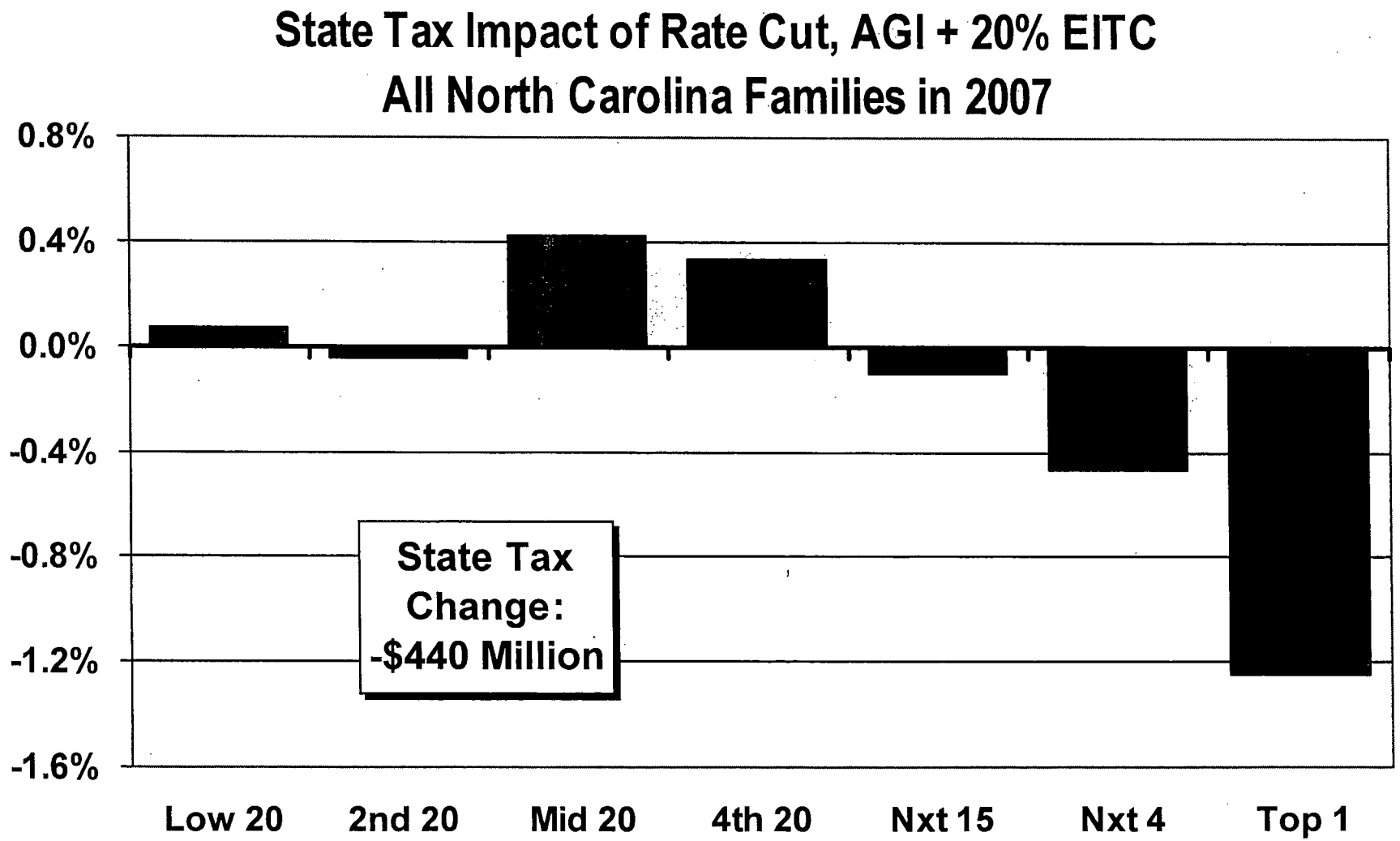

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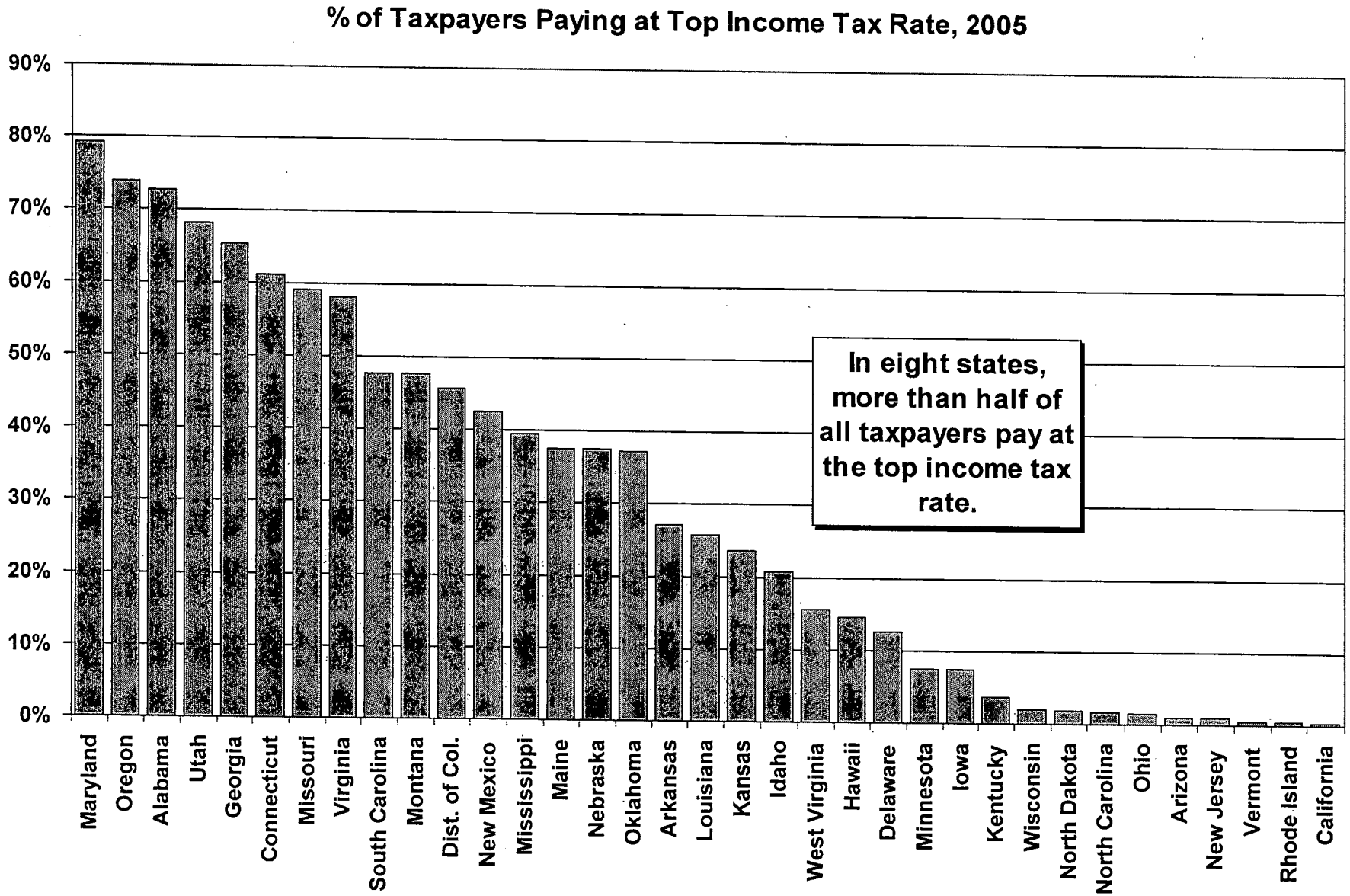
What about Income Tax Volatility?

- Opponents of income tax hikes argue that states with heavy income tax reliance are susceptible to fiscal shortfalls when capital gains decline. But…
- The good times can be really good. (Google stock options responsible for 1/8 of $4 billion income tax growth in California last year.)
- Revenues can be put in Rainy Day Funds in growth periods to get through bad times.
- Temporary rather than permanent tax cuts in good times leave base intact in bad times

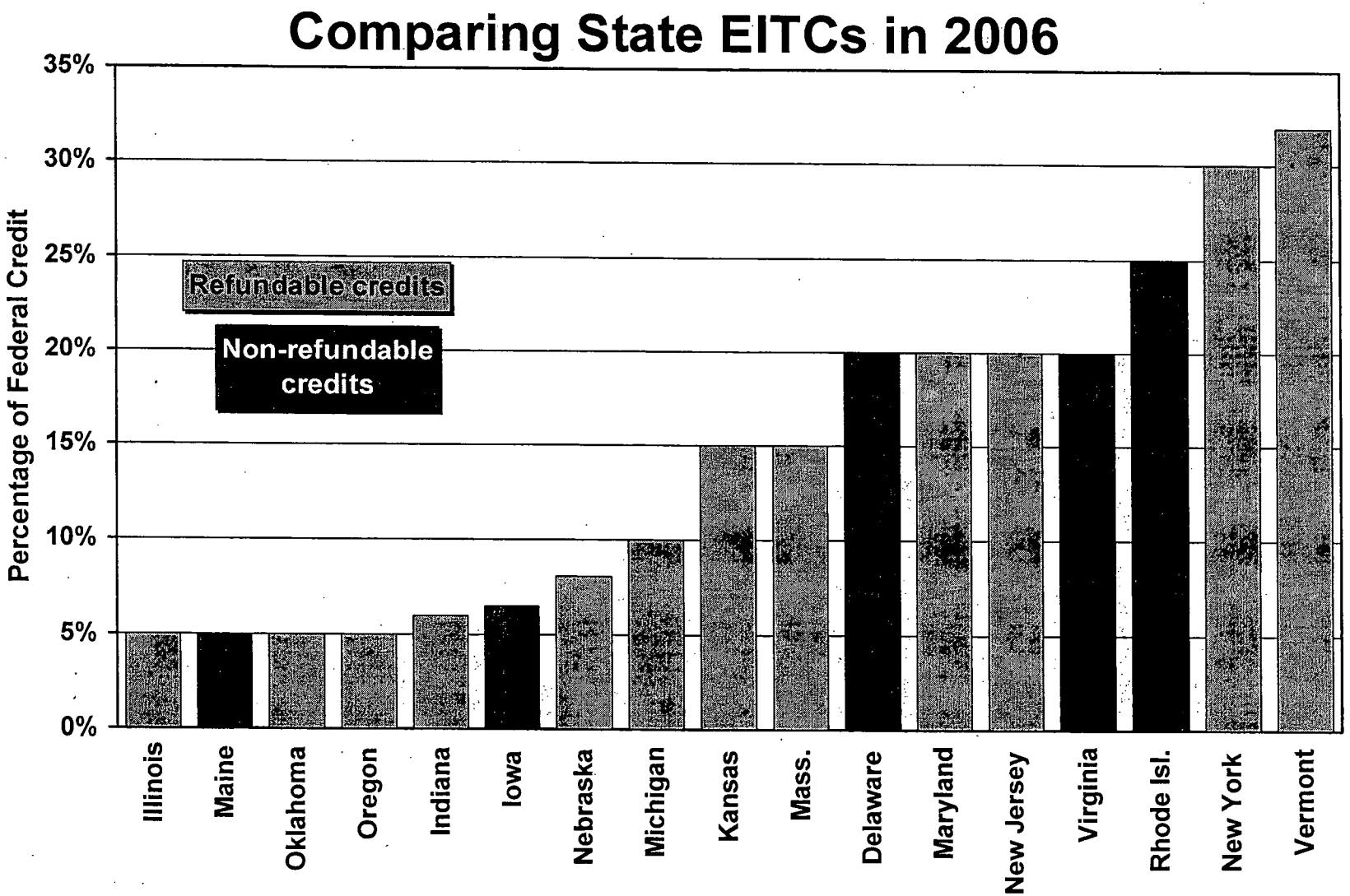
Many state income taxes are "graduated" in name only.



Elderly income tax breaks are usually poorly targeted—and carry a high long-term price tag.

- Many elderly tax breaks benefit pensioners while providing no benefit to wage-earners.
- Most pension tax breaks have no income limits, (Minnesota, Oregon, Virginia impose limits) and some have especially high caps.
- Social Security benefits are completely exempt in most states.
- Rapidly aging population (12.4% over 65 in 2000, almost 20% by 2030) means cost of these breaks will grow rapidly.
- **Poorly-targeted income tax breaks for seniors are a ticking time bomb.**

20 states now have EITC's: but only some are refundable, and some are redundant.

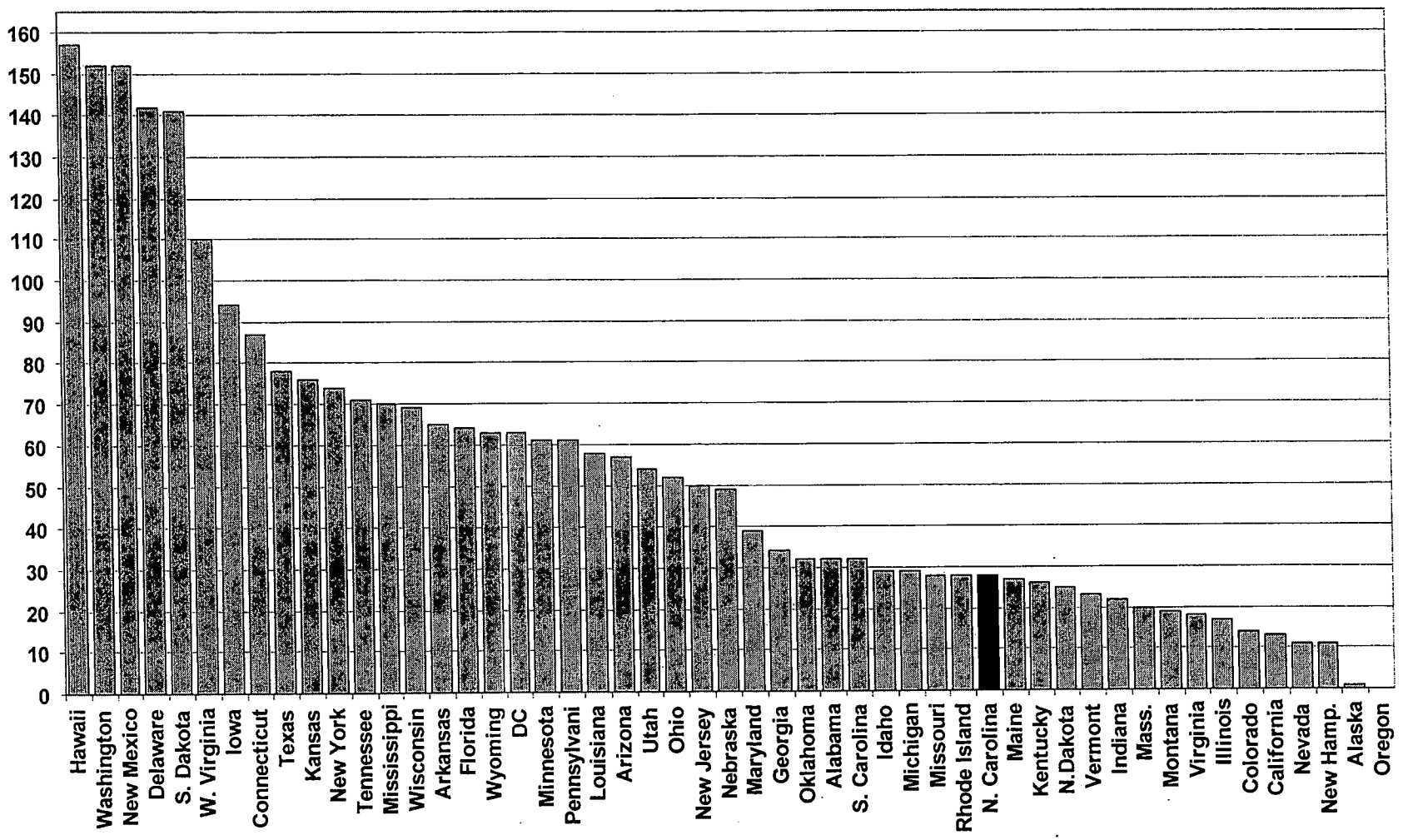


The sales tax: a regressive, but necessary tool for sustainable tax reform

- The most regressive major tax
- *Generally* not deductible on federal income tax returns
- North Carolina exempts many goods and services.
- Services are growing as a share of consumption, while goods are declining– so North Carolina's sales tax is leaking fast.

FTA survey: most states tax less than half of available services.

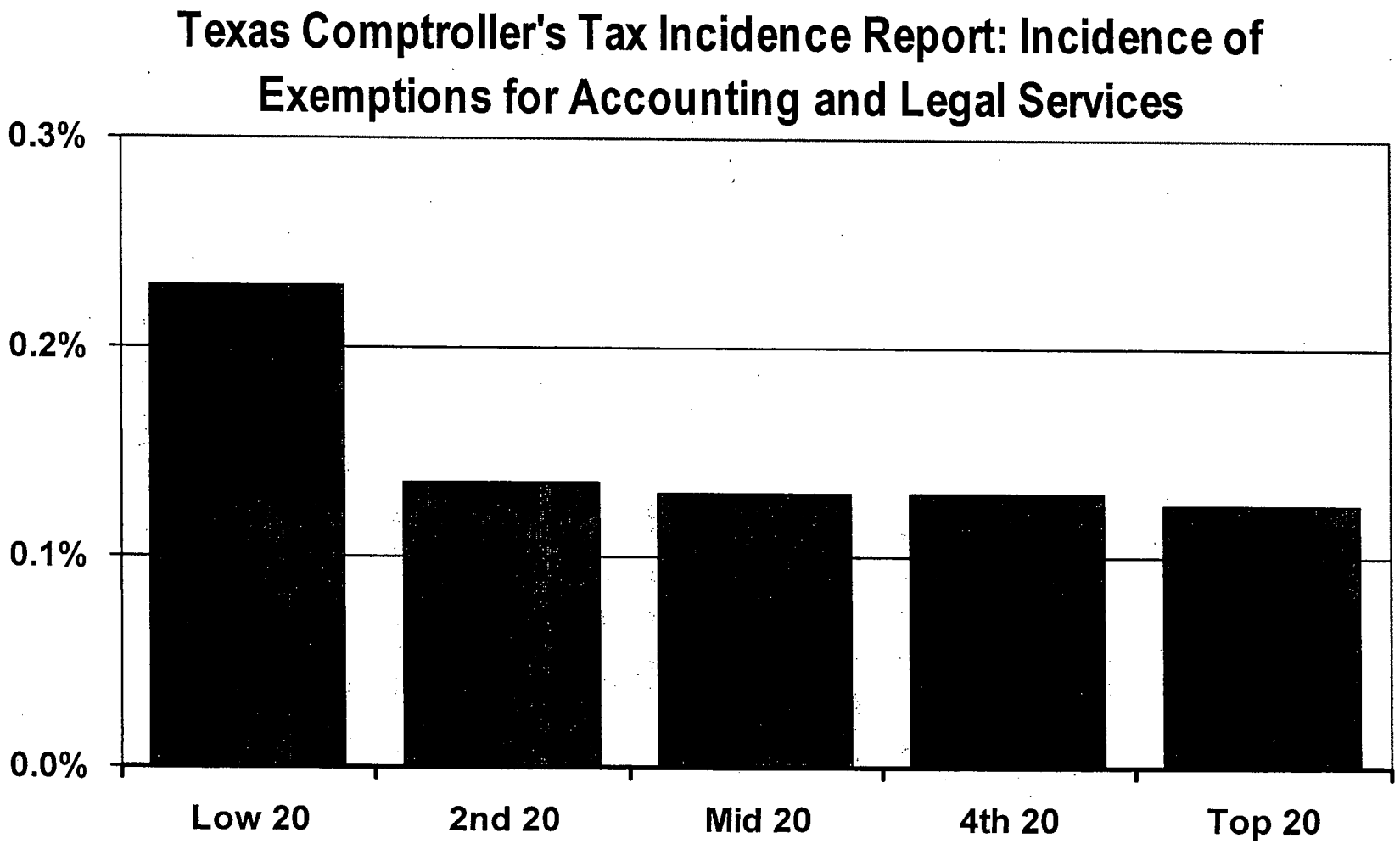
Sales Taxation of Services, 1996



Will Taxing Services Make North Carolina's Sales Tax (More) Progressive?

- Taxing personal services is clearly much less regressive than the current base.
- Taxing some "luxury services" may even be slightly progressive.
- But any substantial base expansion will include services consumed at all income levels– which means comprehensive base expansion is unlikely to make the sales tax much less regressive.
- Taxing business services will likely lead to exporting part of incidence– but in-state portion likely to be regressive.

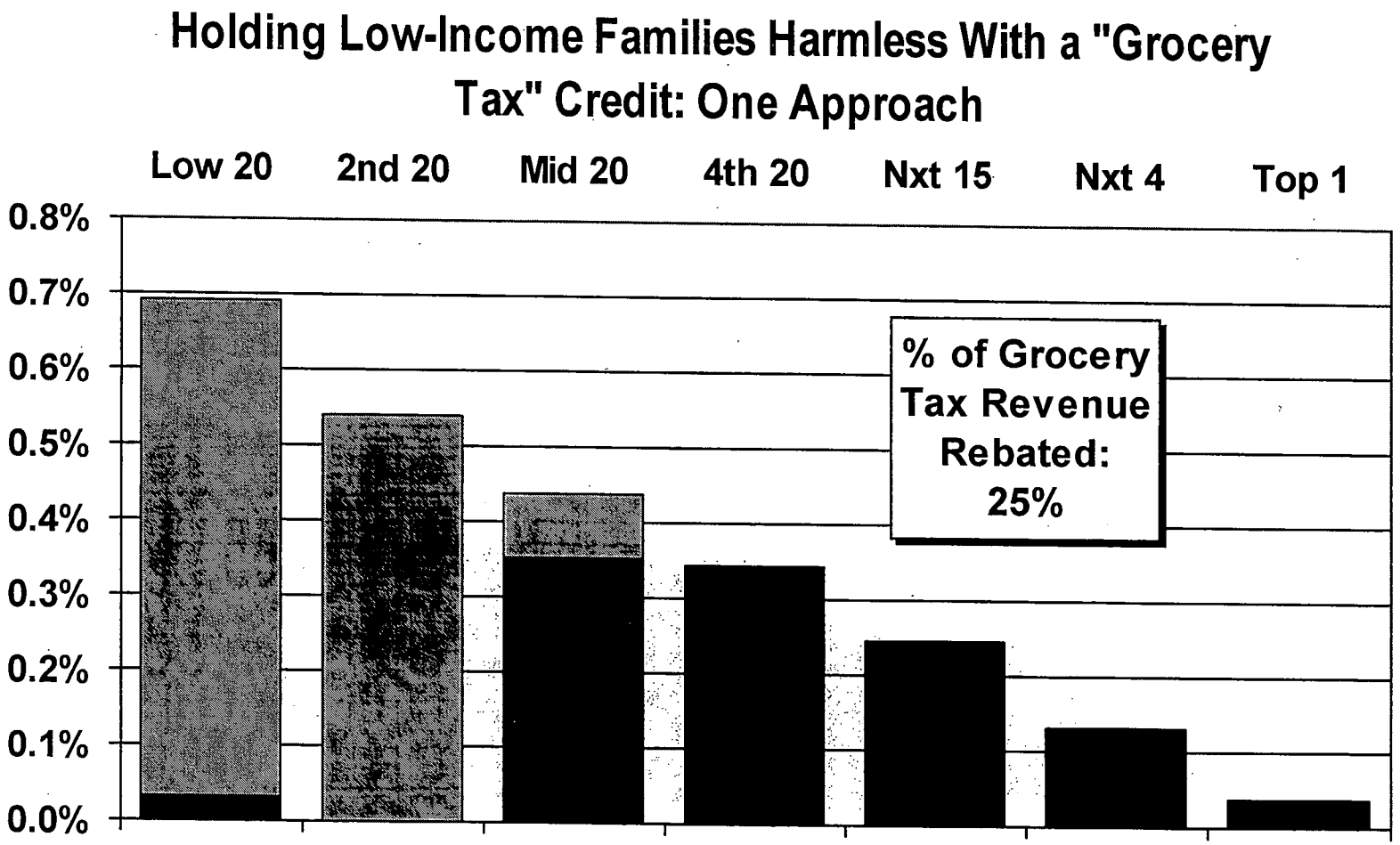
The best state-specific tax incidence model suggests that taxing business services won't be a progressive move.



What About Exempting Groceries. Clothing, Utilities?

- Undeniably a progressive tax cut.
- Cutting the food tax is not a partisan issue.
- But it's expensive. Food can be 10 to 20% of a state's sales tax base.
- If it turns out to be unaffordable, long-term impact can be bad for low-income families
- Cheaper alternatives are available.

A “hold-harmless” sales tax credit is a costly proposition.



Sales tax credits can deliver targeted, low-income sales tax relief at a lower cost than exemptions.

The Kansas Food Sales Tax Refund

Only taxpayers over 55, taxpayers with children under 18, and disabled taxpayers are eligible.

Income Level	Refund
$0 to $12,500	$60 per exemption
$12,501 to $25,000	$30 per exemption
$25,001 or more	no refund

Combined Reporting is the Obvious Corporate Tax Reform Solution– But Disclosure Matters Too

- The SEC requires publicly held corporations to disclose basic information about their federal income tax payments.
- Thanks to these reporting requirements, we know that many of the largest and most profitable corporations have been able to reduce or zero out their tax liability—and we have some ideas about how.
- Most states impose little or no reporting requirements on corporations' state taxes.

Information is Power

- **Disclosure** of corporate tax payments and tax breaks is the gold standard in tax transparency.
- Regular **tax incidence analysis** reminds lawmakers that fairness is lacking.
- **Tax expenditure reports.** Lawmakers (and the public) should know where the money is going.

Summing Up: Strategies for a Sustainable and Fair State Tax System

- **Personal income tax:** the gold standard for tax fairness (and sustainability). Allow low-income credits like the EITC.
- **Corporate income tax:** Better disclosure of tax information.
- **Sales taxes:** Do it right: broad base, low-income credits.

Tax Changes in the States, 2002-2007: Noteworthy legislation

- >25 states increased cigarette taxes
- Massachusetts repealed a capital gains break– and New Mexico created one.
- Major property tax cuts (ID, NE, SC).
- Strengthening corporate income tax (NJ, NY,TX)
- Cutting sales tax on food (NM,UT,WY,SC, WV).
- Income tax rate cuts
- Decoupling from federal tax breaks.
- Continued expansion of EITC

Takeaway Points:

- Fairness-enhancing tax reform can help achieve other worthy tax goals, especially adequacy.
- Income tax cuts are a bad deal for North Carolina– and economic benefits are hard to measure.
- Base-broadening is an important goal, and can be more politically palatable than rate hikes.
- Transparency is an important goal too.
- Recognize the difference between short-term and long-term solutions.
- Taxes and spending are two sides of the same coin.

State Tax Fairness Resources:

- Weekly "Tax Justice Digest." Best and worst of state (and federal) tax politics and policy. Sign up by emailing ctj@ctj.org
- Our tax policy weblog: www.talkingtaxes.org.
- Our website: www.itepnet.org.
- Center on Budget and Policy Priorities (www.cbpp.org).

Tax Related Recommendations

In ranking the specific recommendations shown below, the following general principles are understood:

(1). Overall changes in the tax system should be revenue-neutral.
(2). The tax system should be equitable and fair resulting in similarly situated taxpayers being taxed similarly and similar transactions being taxed in the same manner.
(3). The tax system should be as simple as possible, thereby reducing compliance burdens on taxpayers and administrative burdens on government.
(4). The tax system should provide the government with a sufficient and predictable source of revenue without having to resort to rate increases.
(5). The tax system should be efficient and not impede or reduce the productive capacity of the economy.
(6). The tax system should be competitive with other states in order to promote long-term sustainable economic development, job creation and growth.

Recommendations:

(Rank from 1 to 14 in terms of priority where 1 should be the highest priority item and 14 should be the lowest priority)

_2_ Reduce the top marginal individual income tax rate to a rate that is competitive with other southeastern states.

_3_ Broaden the individual income tax base to federal adjusted gross income with minimal deductions and exemptions.

_5_ Reduce the number of individual income taxpayers by eliminating the filing requirement of those with immaterial taxable income and who pay an insignificant amount of income tax.

_4_ Reduce the corporate income tax rate to a rate that is competitive with other southeastern states.

_6_ Broaden the corporate income tax base by enacting a combined reporting regime for related entities and conduct a comprehensive review of the corporate franchise tax in order to alleviate any possible compliance burdens as a result of two corporate tax reporting systems.

_12_ Repeal the estate and gift taxes.

_8_ Reduce North Carolina's reliance on the individual income tax

_1_ Broaden the sales tax base to include services in a revenue neutral manner and lower the sales tax rate.

_7_ Eliminate differential rates in the sales tax as well as sales tax exemptions (including the food exemption). Some mechanism should be provided to relieve lower income households from any additional tax burden.

_11_ Move all excise taxes to an ad-valorem basis.

_13_ Include privilege taxes as sales/use taxes or eliminate them.

_3_ Give local governments greater flexibility with respect to how they raise revenue to fund the services they provide. A menu of taxes and fees should be available to local governments and should be consistent across the state. The menu should include but not be limited to: options for sales taxes, real estate transfer fees or deed stamp taxes, impact fees, motor vehicle license taxes and vehicle use fees.

_10_ Reduce reliance on the gas tax and use alternative proxies for road use such as an increased vehicle sales tax, motor vehicle license tax, or mileage based fees that would lead to additional resources for transportation infrastructure.

_9_ Give local governments options to provide property tax deferrals for elderly or fixed income residents and to revalue property using annual indexing.

Program Responsibilities and Infrastructure Recommendations

In ranking the specific recommendations shown below, the following general principles are understood:

(1). Needs should be assessed and provided at the lowest possible level of government consistent with economies of scale and other efficiency concerns.
(2). Local functions should be paid for by locally controlled and collected revenue sources and state functions and state mandated functions should be paid for by state controlled and collected revenue sources.
(3). Funding formulas should be driven by need or other factors closely associated with the provision of the service.
(4). Every citizen in North Carolina should be assured of receiving uniform and sufficient opportunities for essential services.
(5). North Carolina and local governments should use debt conservatively and follow the State's debt affordability guidelines.
(6). Any shift from local governments to state government (and vice versa) for funding responsibility must include a swap of revenue authority.
(7). Public infrastructure should be financed by those who benefit most directly from the capital investment.

Recommendations:

(Rank from 1 to 8 in terms of priority where 1 should be the highest priority item and 8 should be the lowest priority).

_1_ The State should assume responsibility for the county share of Medicaid.

_6_ The State should develop and implement wellness programs in order to control the long-term costs of Medicaid and consider other options such as Medicaid HMOs, "fees" for smoking, expanding pay for performance programs and linking benchmark care standards (to be developed by the Governor's office) to reimbursement rates.

_7_ The State should take over funding responsibilities for local election personnel or shift authority for local election personnel to local governments.

_3_ Where appropriate, tolls roads and public/private partnerships may be used to finance transportation projects and increase the speed of completion. Proxies for the use of roads and highways such as the gas tax and highway use tax should remain the prevailing source of revenues for these purposes.

_5_ Local governments should be given flexibility to use Powell Bill funds for projects on state roads.

_4_ The State should issue bonds to replace the 1998 Clean Water Bonds. Funds from these bonds should be allocated to local utilities that have the greatest need and should be used to provide incentives to regionalize or otherwise provide more cost effective services.

_6_ Local governments should assess user rates to cover both capital and operational costs of providing water and sewer infrastructure.

_2_ The State should provide greater flexibility for the use of local tax revenue by lifting some mandates that earmark revenues.

STATE AND LOCAL FISCAL MODERNIZATION STUDY COMMISSION

Monday, April 30, 2007
Room 544, Legislative Office Building
1:00 p.m.

I. Opening Remarks and Approval of Minutes

II. Presentation and Discussion of Priority Recommendations and Alternatives – *Roby Sawyers*

- Broaden the Sales Tax Base and Lower the Sales Tax Rate
  - Services to include in the sales tax base
  - Include food items in the sales tax base
  - Sales tax rate should be set at an amount that may offset revenue losses from changes in the income tax
- Individual Income Tax Changes
  - Broaden the base by basing NC taxable income on federal AGI, with minimal exclusions and deductions
  - Reduce individual income tax rates
  - Provide for a high enough standard deduction that low income taxpayers are not adversely impacted by the recommended changes
  - Provide for personal and dependency exemptions that vary depending on filing status and taxable income
  - Review of income tax credits
- Corporate Income Tax Changes
  - Require combined reporting
  - Reduce corporate income tax rate respectively
- State Assume Responsibility for Nonfederal Share of Medicaid Assistance Program Costs

- State Provide Greater Flexibility to Local Governments
    - Authorization uniformity
    - Review maximum rates for taxes that are authorized for local governments
- Provide Funding for Water and Sewer Infrastructure
- Eliminate Differential Rates in the Sales Tax Base
    - Highway use tax rate applicable to motor vehicles should be the same as the combined general sales tax rate
    - Gross receipts tax rate on admissions and amusements should be the same as the combined general sales tax rate
    - Highway use tax rate applicable to long-term leases and rentals of motor vehicles should be the same as the combined general sales tax rate
- Property Tax Relief
    - Give local governments the option of providing property tax deferrals for elderly and fixed income residents
    - Require more frequent review of property tax assessments

III. • SB 487/HB 1566: Extend Fiscal Modernization Report Deadline

IV. Adjournment

VISITOR REGISTRATION SHEET

State & Local Fiscal Modernization — April 30, 2007

Name of Committee — **Date**

VISITORS: PLEASE SIGN IN BELOW AND RETURN TO DeANNE MANGUM

NAME	FIRM OR AGENCY AND ADDRESS
Leon M Killian	Nelson Mullins
Larry Hirsch	NCGA
Betsy Bailey	PENC
Mehul Khajuria	NCMC
DAVID THOMPSON	NCACC
Rebecca Troutman	NCACC
Amy McConkey	Smith Anderson
Cheronia Nimmons-Wright	MVA
Sara Warren	Wake Gov
Jennifer Willis	Wake Co. gvt
Reid Hartzog	NCTA

VISITOR REGISTRATION SHEET

State & Local Fiscal Modernization — April 30, 2007

Name of Committee — **Date**

VISITORS: PLEASE SIGN IN BELOW AND RETURN TO DeANNE MANGUM

NAME	FIRM OR AGENCY AND ADDRESS
Patrick Buffkin	Nelson Mullins
Cindy McCall	[illegible]
Dennis Patterson	OSC
Roland Stephen	IEI
Beverly Hardy	League of Women Voters
Mary Klenz	" " " NC
June Kimmel	" " " NC
Bill Murrell	NC Rural Center
Daniel Baum	Kennedy Covington

VISITOR REGISTRATION SHEET

State & Local Fiscal Modernization — April 30, 2007

Name of Committee — **Date**

VISITORS: PLEASE SIGN IN BELOW AND RETURN TO DeANNE MANGUM

NAME	FIRM OR AGENCY AND ADDRESS
Michael Houser	NCHE

Recommendations of the State and Local Fiscal Modernization Study Commission to the General Assembly:

The following recommendations have been identified as high priority items by the State and Local Fiscal Modernization Study Commission. In summary, the recommendations:

- make the sales tax more progressive by broadening the sales tax base to include many services that are currently exempt from the sales tax (warranty and repair services, entertainment services, etc.) and by broadening the sales tax base to include currently exempt food items;

- broaden the individual income tax base, take low-income taxpayers off the tax rolls and reduce income tax rates across all income levels;

- reduce the top corporate tax rate and adopt combined reporting;

- provide relief to local government through the State's assumption of a portion of Medicaid costs;

- provide greater flexibility to city and county governments with respect to how they raise revenue by allowing a menu of options including real estate transfer fees or deed stamp taxes, impact fees, motor vehicle license fees and other vehicle use fees, taxes on prepared food and drink, and occupancy taxes;

- provide funding for water and sewer infrastructure;

- eliminate differential sales tax rates; and

- modernize the local ad valorem tax on real property and provide local governments flexibility in providing tax relief for elderly and fixed income residents.

The Commission believes that these recommendations should be approved by the General Assembly and signed into law by the Governor during this legislative session. As the General Assembly considers options to modernize the state and local system of taxation, the Commission respectfully urges its members <u>not</u> to make changes unless they are consistent with these recommendations. Members of the General Assembly should also be aware that the Commission has made other recommendations which while not as high a priority are nonetheless important and should be considered by the legislature in the future.

Each of the recommendations can stand alone with the exception of the first and second recommendations. Significant income tax rate reductions can only be accomplished in a revenue-neutral manner by offsetting the revenue loss with additional revenue from broadening the sales tax base.

Detailed revenue estimates of each recommendation are not available at this time. Accordingly, it may be necessary to adjust tax rates in order for the recommendations to be revenue neutral. In addition, a detailed incidence analysis of the recommendations is not available at this time. To the extent that low-income taxpayers are adversely affected by the recommendations, the proposed standard deduction and or exemption amounts should be modified.

Specific Recommendations:

1. Broaden the sales tax base and lower the sales tax rate.

   (A). Effective January 1, 2008, the following services which are commonly taxed by other states should be included in the sales tax base and taxed at the combined general rate:
   - pet grooming services;
   - landscaping;
   - typesetting;
   - storage (automotive, fur, household goods, marina services, and so on);
   - carpet and upholstery cleaning;
   - garment repair and altering;
   - gift and package wrapping;
   - services provided by health clubs and tanning parlors;
   - shoe repair;
   - swimming pool cleaning and maintenance;
   - janitorial services;
   - exterminating services;
   - telephone answering services;
   - tire recapping and repairing;
   - window cleaning;
   - automotive services;
   - entertainment services (some of which are currently taxed at 3%);
   - warranty services; and
   - currently exempt installation and repair services.

   The Commission recommends that the sales tax should be expanded to include a broad range of additional services but has identified significant issues which must be addressed before final recommendations can be made.

   (B). Effective January 1, 2008, currently exempt food items should be taxed at the combined general rate. The Commission recommends that low-income taxpayers receive targeted income tax relief to offset the additional sales tax burden caused by taxing food at the combined general sales tax rate.

   Increases in sales tax revenue from the base broadening described above should be used to offset revenue losses from changes in the income tax. To the extent that additional sales tax revenue exceeds reductions in income tax revenue, both state and local sales tax rates should be lowered in a revenue neutral fashion.

2. Reduce the top marginal individual income tax rate, broaden the individual income tax base and reduce the number of individual income tax filers.

(A). Effective January 1, 2008, the base for calculating North Carolina taxable income should be federal adjusted gross income (AGI) with minimal exclusions and deductions as required by law (retirement income exempted from North Carolina income tax under the *Bailey* decision, interest on federal obligations, interest on in-state municipal bonds) or equity considerations (North Carolina income tax refunds included in federal AGI and a deduction for higher education tuition payments when a credit is claimed on the federal return).

(B). Effective January 1, 2008, individual income tax rates should be reduced as shown in the following table:

Marginal Rate on Taxable Income*	Single/MFS	MFJ/QW	HOH
3 – 4%	Up to $10,000	Up to $20,000	Up to $15,000
4 – 5%	$10,001 - $60,000	$20,001 - $120,000	$15,001 - $90,000
5 – 6%	$60,001 - $120,000	$120,001 - $240,000	$90,001 - $180,000
6 – 7%	$120,001 +	$240,000 +	$180,000+

* The proposed rates assume that additional revenues from broadening the sales tax will be used to offset revenue losses resulting from reductions in individual income tax rates. To the extent that increased revenues from the sales tax are used to reduce sales tax rates and not income tax rates, the rate reductions proposed above will not be possible.

(C). Effective January 1, 2008, a standard deduction from federal AGI should be allowed. For low income taxpayers, this standard deduction is intended to remove significant numbers of taxpayers from tax filing and payment obligations and to offset the impact of increasing sales taxes. A smaller standard deduction should be allowed for taxpayers with moderate and higher amounts of income.

The standard deduction should range from $0 to $16,000 as shown in the following table:

Standard Deduction**	Single/MFS	MFJ/QW	HOH
$8,000/$16,000/$12,000	$0 - $60,000	$0 - $120,000	$0 - $90,000
$4,000/$8,000/$6,000	$60,001 - $120,000	$120,001 - $240,000	$90,001 - $180,000
None	$120,001 +	$240,000 +	$180,000+

* These amounts should be modified as necessary in order to ensure that low income taxpayers are not adversely impacted by the recommended changes.

(D). Effective January 1, 2008, deductions from federal AGI should be allowed for personal and dependency exemptions. The allowable exemption amount should vary depending on filing status and North Carolina taxable income as shown below:

Exemption Amount	Single/MFS	MFJ/QW	HOH
$2,000	$0 - $60,000	$0 - $120,000	$0 - $90,000
$1,200	$60,001 - $120,000	$120,001 -$240,000	$90,001 - $180,000
None	$120,001 +	$240,000 +	$180,000+

Comparison of Tax Payment Thresholds Under Current Law with Recommended Changes

Under current law, the first $5,500 of income of a single taxpayer with no dependents would be exempt from North Carolina income tax. Under the Commission's recommendations, this taxpayer could earn up to $10,000 without owing any North Carolina income tax.

Under current law, a taxpayer that files as head of household with two dependents would pay no income tax on $15,224 of income (after taking into account the current child credit of $100 per child). Under the Commission's recommendations, this taxpayer could earn up to $18,000 without owing any North Carolina income tax (before any allowable child tax credit).

Under current law, $11,000 of income of a married couple with no children would be exempt from North Carolina income tax. Under the Commission's recommendations, this taxpayer could earn up to $20,000 without owing any North Carolina income tax.

Under current law, a married couple with two children would pay no income tax on the first $19,334 of income (after taking into account the current child credit of $100 per child). Under the Commission's recommendations, this family could earn up to $24,000 without owing any North Carolina income tax (before any allowable child tax credit).

(E). Under current law, a variety of income tax credits are allowed including credits for child and dependent care expenses, credits for children, credits for charitable contributions for non-itemizers, credits for qualified business investments, business incentives and energy tax credits, credits for disabled taxpayers, dependents and spouses, credits for real property land donations, credits for rehabilitating historic structures and mill facilities, credits for property taxes on farm machinery, credits for handicapped dwelling units, credits for conservation tillage equipment, credits for gleaned crops, credits for poultry composting, and credit for recycling oyster shells.

The Commission recommends that the Revenue Laws Study Committee should review the current individual income tax credits to determine the extent to which the current credits should be continued, recommend any phase-outs of the current credits and determine the extent to which the tax rates above would need to be adjusted in order to maintain revenue neutrality if any or all credits are retained. The Revenue Laws Study Committee should also consider whether an education deduction should be allowed for higher education tuition payments when an education credit is taken instead of a deduction for federal tax purposes.

3. Reduce the corporate income tax rate and require combined reporting.

Effective January 1, 2009, affiliated groups of corporations that are engaged in a unitary business should be required to file combined returns. An affiliated group is defined as a group of two or more corporations in which more than 50% of the voting stock of each member corporation is directly or indirectly owned by a common owner or owners, either corporate or non-corporate, or by one or more of the member corporations. A unitary business is defined as one or more related business organizations engaged in business activity both within and without the State among which one or more of the following exist: a unity of ownership, operation or use or an interdependence in their functions. A unitary business should be defined as broadly as allowed under current judicial authority.

Members of a combined group should be allowed to make a "water's edge" election and thereby elect to disregard the income and apportionment factors of a member of the combined group that is a foreign corporation that conducts eighty percent or more of its business activity outside the United States and outside a tax haven country.

The corporate tax rate should be reduced in a revenue neutral fashion. Based on conservative assumptions of the impact of combined reporting, the corporate rate should be reduced to 6% or lower.

4. The State should assume responsibility for the nonfederal share of Medicaid Assistance Program costs, excluding administrative costs.

Alternatives include:

(A). An immediate takeover at a cost to the State of approximately $500 to $600 million, or

(B). A takeover accomplished over 3 to 4 years. Alternatives include:

(1). assuming responsibility for a portion of Medicaid in excess of a percentage of property values in each county. Complete Medicaid relief would be phased-in over 3 to 4 years by reducing the threshold required for relief. For example, the State could immediately assume responsibility for Medicaid expenditures in excess of the revenue received by a $.10 tax on real property within each county. The one-year cost to the state would be approximately $51 million. Phasing in the takeover in this manner would provide immediate relief for about one-third of the counties in the State.

(2). cutting the county share of Medicaid across the board in order to provide relief to all counties.

The shift in responsibility from the counties to the State should be accompanied by a shift in funding sources or by the State identifying new sources of revenue. A shift in funding sources could be accomplished through the counties giving up the 2% local sales tax on food or other sources of revenue currently shared among the State and the counties such as the 2.5% local sales tax, lottery proceeds, corporate income tax, etc.

5. The State should provide greater flexibility to city and county governments with respect to how they raise revenue by providing a menu of options including real estate transfer fees or deed stamp taxes, impact fees, motor vehicle license fees and other vehicle use fees, taxes on prepared food and drink, and occupancy taxes.

   Each city and county government should have the same authority and the ability to pick and choose which revenue sources are appropriate.

   The Revenue Laws Study Committee should study and set maximum rates for each tax.

6. Provide funding for water and sewer infrastructure.

The State of North Carolina should issue bonds, the proceeds of which should be used to provide funding for water and sewer infrastructure. Funds should be allocated to local utilities with the greatest need and should be used to provide incentives to regionalize or otherwise provide more cost effective services.

7. Eliminate differential rates in the sales tax.

The following transactions that are currently subject to sales or excise tax at special rates should be taxed at the combined general sales tax rate.

(A). All sales of motor vehicles taxed under the highway use tax. The tax is to be assessed on the retail value of the motor vehicle with no reduction for an allowance given by the seller for trade-ins. Taxes collected on motor vehicles at the combined general tax rate should be credited to the North Carolina Highway Trust Fund.

(B). Admissions and amusements currently taxed at 3%.

(C). Long-term leases and rentals of motor vehicles.

8. Modernize the local ad valorem tax on real property and provide local governments flexibility in providing tax relief for elderly and fixed income residents.

(A). Effective January 1, 2008, local governments should be given the option to provide property tax deferrals for elderly and fixed income residents. Requirements for deferral and events that result in the payment of deferred tax should be uniform across the state and determined by the Property Tax Subcommittee of the Revenue Laws Study Committee.

(B). Effective January 1, 2008, the State should require each county of the State to:

(1). reappraise all real property in any year following a year in which the median sales assessment ratio (as conducted by the Department of Revenue) does not exceed .90, or

(2). revalue property on an annual basis using annual indexing with an index to be determined for each county by the Department of Revenue.

- The corporate income tax base should be broadened by requiring some method of combined reporting, with revenue gains from this change used to reduce the tax rate in a revenue-neutral fashion.
- The Medicaid challenge facing counties should be addressed with a long-term solution that is sustainable and fair for both the state and counties.
- The State should provide greater flexibility to city and county governments with respect to how they raise revenue by allowing a menu of revenue options.

As the General Assembly considers options to modernize the state and local system of taxation, the Commission respectfully urges its members to avoid making changes that are inconsistent with the guidelines listed above. Furthermore, the Commission believes that in order to be effective, tax reform must be comprehensive. The Commission has identified a list of high priority items for your consideration. These recommendations are provided as an attachment to this letter.

We hope this update is useful to you as budget, tax, and debt policy discussions continue.

Sincerely,

Senator David Hoyle
Cochair

Senator Tony Rand
Cochair

Representative Becky Carney
Cochair

Dan Gerlach
Cochair

GENERAL ASSEMBLY OF NORTH CAROLINA

SESSION 2007

H 1

HOUSE BILL 1566*

Short Title:	Extend Fiscal Modernization Report Deadline.	(Public)
Sponsors:	Representatives Carney, Barnhart (Primary Sponsors); Faison, Glazier, and Harrison.	
Referred to:	Rules, Calendar, and Operations of the House.	

April 18, 2007

A BILL TO BE ENTITLED

AN ACT TO EXTEND THE REPORTING DEADLINE FOR THE STATE AND LOCAL FISCAL MODERNIZATION STUDY COMMISSION.

The General Assembly of North Carolina enacts:

SECTION 1. Section 47.5 of S.L. 2006-248 reads as rewritten:

"**SECTION 47.5.** The Commission shall report its ~~finding and recommendation~~ findings and recommendations to the 2007 Regular Session of the General Assembly no later than ~~May 1, 2007.~~ May 1, 2008. The Commission may make one or more interim reports. The Commission shall terminate upon the filing of its final report."

SECTION 2. This act is effective when it becomes law.

GENERAL ASSEMBLY OF NORTH CAROLINA

SESSION 2007

S 1

SENATE BILL 487

Short Title:	Extend Fiscal Modernization Report Deadline.	(Public)
Sponsors:	Senator Hoyle.	
Referred to:	Rules and Operations of the Senate.	

March 6, 2007

A BILL TO BE ENTITLED

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SECTION 1. Section 47.5 of S.L. 2006-248 reads as rewritten:

"**SECTION 47.5.** The Commission shall report its ~~finding and recommendation~~ findings and recommendations to the 2007 Regular Session of the General Assembly no later than ~~May 1, 2007.~~ May 1, 2008. The Commission may make one or more interim reports. The Commission shall terminate upon the filing of its final report."

SECTION 2. This act is effective when it becomes law.

STATE AND LOCAL FISCAL MODERNIZATION STUDY COMMISSION
Wednesday, February 20, 2008 at 10:00 am
Room 544, Legislative Office Building

MINUTES

The State and Local Fiscal Modernization Study Commission met at 10:00 AM on February 20, 2008, in Room 544 of the Legislative Office Building. Seventeen members of the committee were present. Senator Hoyle presided as chair.

Approval of Minutes

Senator motioned to approve the prior meeting's minutes and Joe Carpenter seconded the motion. The motion carried. A copy of the minutes is attached.

Review of Commission Findings and Recommendations to the 2007 General Assembly and Review of 2007 Legislative Actions relating to those Findings and Recommendations

Cindy Avrette, Research Division staff attorney, was recognized. She outlined which committee recommendations led to new legislation and which issues remained to be studied for future recommendations. A copy of her power point is attached.

Business Taxes Generally and New Alternative Tax Structures to Tax Business Income

William F. Fox, Professor of Economics at the University of Tennessee and Director, Center for Business and Economic Research, was recognized. He discussed business tax collections, state tax rates, and alternatives for taxing businesses. A copy of his power point is attached

Total State and Local Business Taxes: Fiscal Year 2006

Andrew Phillips, Senior Manager in the Quantitative Economics and Statistics group of Ernst & Young, was recognized. He discussed his 2007 study of the impact of state and local business taxes on economic competitiveness. A copy of his power point and his published study is attached.

The meeting adjourned at 12:05 p.m.

Senator David Hoyle, Cochair

Representative Becky Carney, Cochair

Senator Tony Rand, Cochair

DeAnne Mangum, Committee Clerk
State and Local Fiscal Modernization Study Commission

STATE AND LOCAL FISCAL MODERNIZATION STUDY COMMISSION

Wednesday, February 20, 2008
Room 544, Legislative Office Building
10:00 a.m.

I. **Opening Remarks and Approval of Minutes**

II. **Review of Commission Findings and Recommendations to the 2007 General Assembly and Review of 2007 Legislative Actions Relating to those Findings and Recommendations**

Cindy Avrette, Research Division, NCGA

III. **Business Taxes Generally and New Alternative Tax Structures to Tax Business Income**

William F. Fox, Professor of Economics at the University of Tennessee and Director, Center for Business and Economic Research

IV. **Total State and Local Business Taxes: Fiscal Year 2006**

Andrew Phillips, Senior Manager in the Quantitative Economics and Statistics group of Ernst & Young, LLP

V. **Committee Discussion**

VI. **Adjournment**

VISITOR REGISTRATION SHEET

State & Local Fiscal Modernization — Feb. 20, 2008

Name of Committee — **Date**

VISITORS: PLEASE SIGN IN BELOW AND RETURN TO DeANNE MANGUM

NAME	FIRM OR AGENCY AND ADDRESS
DAVID BARNES	Poyner + Spruill
Terri Todd	North Carolina Beverage Assoc.
Jay Stem	NC Aggregates Assoc.
Cam Cowell	TBPM HL
Michael Haley	Commerce
Elizabeth Dalton	NCPMA
LUCINS PULLEN	ATTORNEY
Rob Schofield	NC Policy Watch
Patrick Buffkin	Nelson Mullins
JOHN GOODMAN	NC CHAMBER

VISITOR REGISTRATION SHEET

State & Local Fiscal Modernization — Feb. 20, 2008

Name of Committee — **Date**

VISITORS: PLEASE SIGN IN BELOW AND RETURN TO DeANNE MANGUM

NAME	FIRM OR AGENCY AND ADDRESS
Dan Schisler	East Carolina Univ.
Chris Fitzsimon	NC Policy Watch
Mitch Kokai	John Locke Foundation
John McAlister	NC Chamber
Cecil G Bass	NCAE
JOEL RAUPE	Rep. Stam

VISITOR REGISTRATION SHEET

State & Local Fiscal Modernization — Feb. 20, 2008

Name of Committee — **Date**

VISITORS: PLEASE SIGN IN BELOW AND RETURN TO DeANNE MANGUM

NAME	FIRM OR AGENCY AND ADDRESS
Michael Hauser	NC Dept of Revenue
Meg Gray	NC BTC
Gregg Thompson	NFIB
Cam Brandy	E&Y
Donna Powell	NC Dept. Revenue
Rebecca McGhee	Smith Anderson
Amy Schulder	McGuireWoods
Rebecca Tindall	NCACC
DAVID THOMPSON	NCACC
Diane Getz	League of Womens Voter
ROBERT STEPHENS	IEI

House Pages

Name Of Committee: J1. State & Local Fiscal Modernization Committee Date: 2-20-08

1. Name: _____

County: _____

Sponsor: _____

2. Name: _____

County: _____

Sponsor: _____

3. Name: _____

County: _____

Sponsor: _____

4. Name: _____

County: _____

Sponsor: _____

5. Name: _____

County: _____

Sponsor: _____

House Sgt-At-Arms

1. Name: John Brandon
2. Name: Charles Williams
3. Name: Earl Coker
4. Name: Frank Prevo
5. Name: –

SENATE

State & Local Fiscal Modernization Study Commission

Cindy Avrette
Research Division, NCGA
February 20, 2008

State & Local Fiscal Modernization Study Commission

- Diverse Commission
- Charged to examine revenue sharing, taxing authority, and division of responsibility
- Formed subcommittees
- Developed and ranked priorities
- Review Commission Findings and Recommendations
- Review Related 2007 Legislative Actions
- Further Commission Discussion

Commission Findings

- NC State and local tax system insufficient
- Relatively high individual and corporate income tax rates
- Tax system complicated
- Local governments need additional revenue sources
- Burdensome Medicaid costs

Commission Guidelines

- Broaden income and sales tax bases
- Lower rates
- Reduce number of low-income taxpayers
- Long-term Medicaid solution
- Greater revenue flexibility for local governments

Letter to Legislative Members

"North Carolina's tax system is out of date and needs fixing. ... Our system of revenue must be changed ... to meet the operating and infrastructure needs of the future."

"As the General Assembly considers options to modernize the State and local system of taxation, the Commission respectfully urges its members to avoid making changes that are inconsistent with the guidelines listed above. Furthermore, the Commission believes that in order to be effective, tax reform must be comprehensive."

Recommendation: Medicaid

- The State should assume responsibility for the nonfederal share of Medicaid costs, excluding administrative costs. The shift in responsibility should be accompanied by a shift in funding sources or by the State identifying new funding sources.

Legislative Action: Medicaid

- State assume costs of Medicaid
  - Assume 25% of the county share, Oct 2007
  - Assume 50% of the county share, July 2008
  - Assume 100% of the county share, July 2009
- Counties remain responsible for administrative costs.
- Two hold harmless provisions
  - Counties hold cities harmless for loss of sales tax revenue
  - State ensure that each county benefits by at least $500,000

Legislative Action: Shift in Funding Sources

- State sales tax rate remains at 4.25%
- FY 07-08 only
  - Adjust amount distributed from corporate income tax receipts under the Public School Building Capital Fund
- Effective October 1, 2008
  - Local third ½ cent sales tax rate reduced to ¼ cent
  - State sales tax rate increases from 4.25% to 4.5%
- Effective October 1, 2009
  - Local third ¼ cent sales tax rate repealed
  - State sales tax rate increases from 4.5% to 4.75%

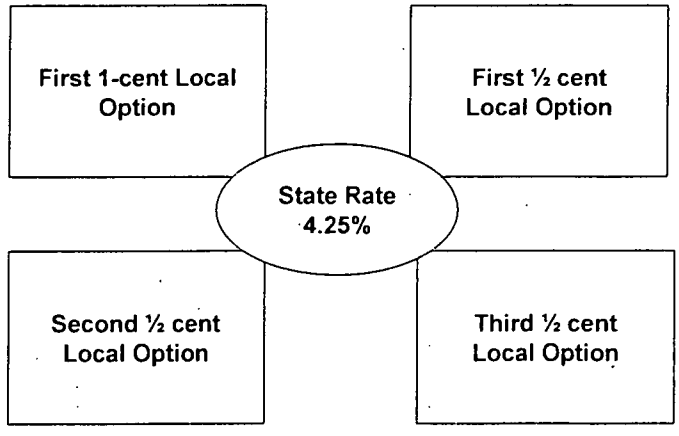
Recommendation: Local Revenue Options

- The State should provide greater flexibility to city and county governments with respect to how they raise revenue by allowing a menu of options including real estate transfer fees or deed stamp taxes, impact fees, motor vehicle license fees, and other vehicle use fees, taxes on prepared food and drink, general sales taxes, and occupancy taxes.

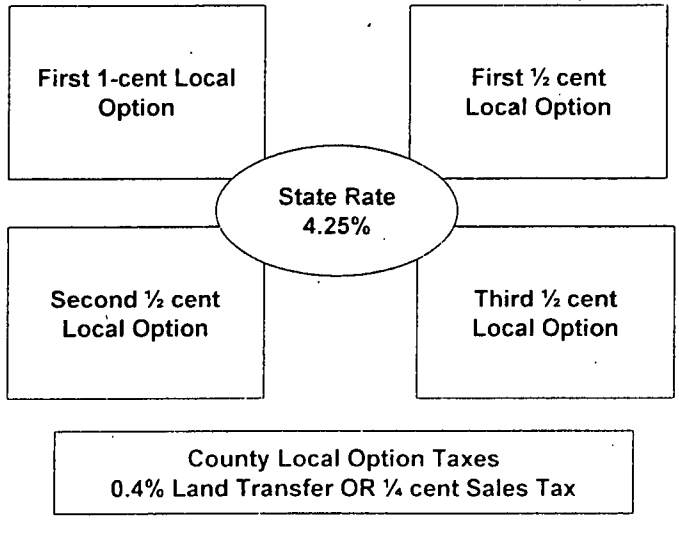
Legislative Action: Local Revenue Options

- Created two new local taxes:
  - Land transfer tax up to .4%
  - ¼ cent sales tax
- A county may choose to levy one or the other, if approved by the voters
- Effective July 31, 2007
- Referendums
  - Land transfer: 0 out of 16
  - Sales tax: 5 out of 13

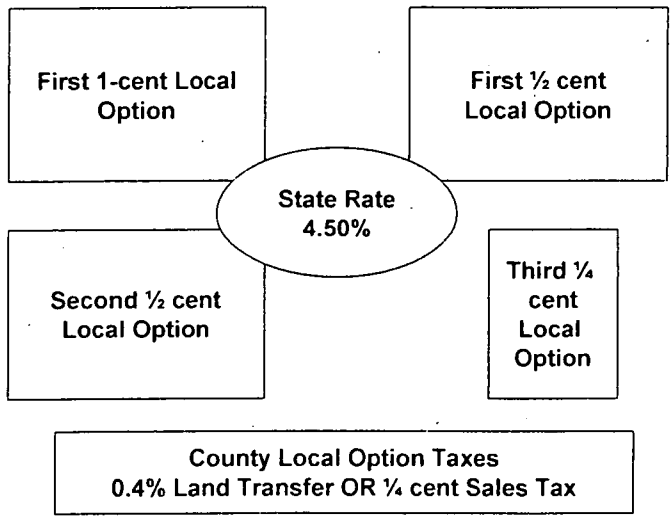
Sales Tax Rate 6.75%
Prior to January 2008



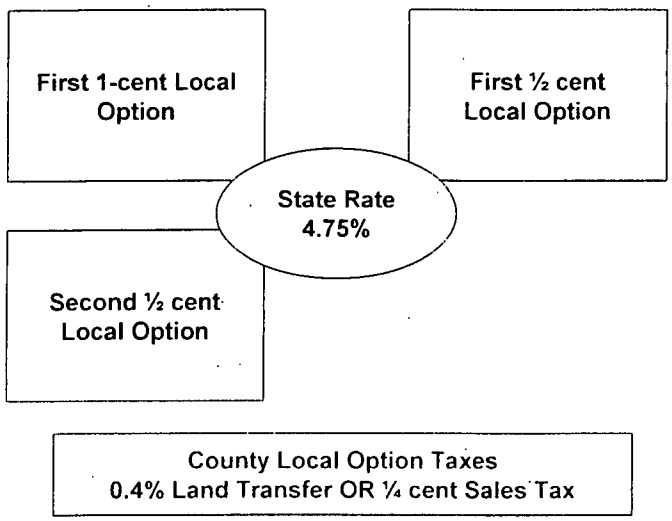
Sales Tax Rate 6.75% or 7%
January 2008



Sales Tax Rate 6.75% or 7% October 2008



Sales Tax Rate 6.75% or 7% October 2009



Recommendation: Sales Tax

- The State should broaden the sales tax base. To the extent the sales tax base is broadened, tax rates should be reduced in a revenue neutral fashion. To the extent that base broadening results in increased tax burdens on low-income taxpayers, the State should provide a mechanism to offset this increase.

Legislative Action: Sales Tax

- Four-year phase out of the sales tax on electricity, PNG, and fuel
  - Applicable to manufacturing facilities and farming operations
  - Effective October 1, 2007
  - Fully phased-out by July 1, 2010
  - Cost = $10 million
- Exemption for commercial fishing
- Exemption for Baler Twine
- Exemption for Baked Goods
  - Covers Thrift Stores
- Expansion of Sales Tax Refunds and Exemptions (Incentives)
  - 1%, $80 cap excise tax
  - Analytical research services
  - Railroad Intermodal facilities

Recommendation: Individual Income Tax

- The State should reduce individual income tax rates and broaden the individual income tax base to federal AGI with minimal exclusions and deductions. Increases in revenue as a result of the base broadening should be used to reduce tax rates in a revenue neutral fashion.

Legislative Action: Individual Income Tax

- Upper Income Tax Bracket Expires
  - 8% tax bracket sunsets for taxable years beginning on or after January 1, 2008
- Refundable State Earned Income Tax Credit
  - 3.5% of federal credit
  - Effective 2008
  - Expires 2013
- Expanded the 529 Plan Tax Deduction
- Established Firefighter/EMS Tax Deduction
- Two Tax Credits – Adoption and LTC

Recommendation: Property Tax

- The State should allow counties to reappraise real property more frequently, reappraise real property on an annual basis using annual indexing and provide local governments the option of providing property tax relief for low-income elderly and fixed income residents.

Legislative Action: Property Tax

- Homestead Exclusion
  - Increase exemption amount
  - Increase baseline income limit amount July 2008
- Revaluation Schedule
  - SB 1309
  - Quadrennial Plan
  - Postponement instead of advancement, if sales assessment ratio > .90.
- Senior Circuit Breaker
  - Deferral of property tax in excess of 4% of person's income
  - Eligibility requirements
  - Lien on property
  - If disqualified, taxes for current year and preceding 3 years become due
  - July 2009

Other Recommendations

- The State should eliminate differential rates and caps in the sales tax and tax sales of motor vehicles at the combined general sales tax rate.
- The State should provide a mechanism to remove low-income taxpayers from tax filing and payment responsibility.
- The State should issue bonds, the proceeds of which should be used to provide funding for water and sewer infrastructure.

Recommendation: Corporate Income Tax

- The State should broaden the corporate income tax base by requiring some method of combined reporting for affiliated groups of corporations engaged in a unitary business. Increases in revenue as a result of combined reporting should be used to reduce the corporate income tax rate in a revenue neutral fashion.

Commission Discussion

- Individual Income Tax Reform
  - Broaden base, lower rate
- Sales Tax Reform
  - Broaden base, lower rate
- Infrastructure Funding Needs & Solutions
- Corporate Income Tax Reform
  - Business Taxes
  - Broaden base, lower rate

Issues in the State Taxation of Business

Presented to
North Carolina Fiscal Modernization Commission
Raleigh, North Carolina

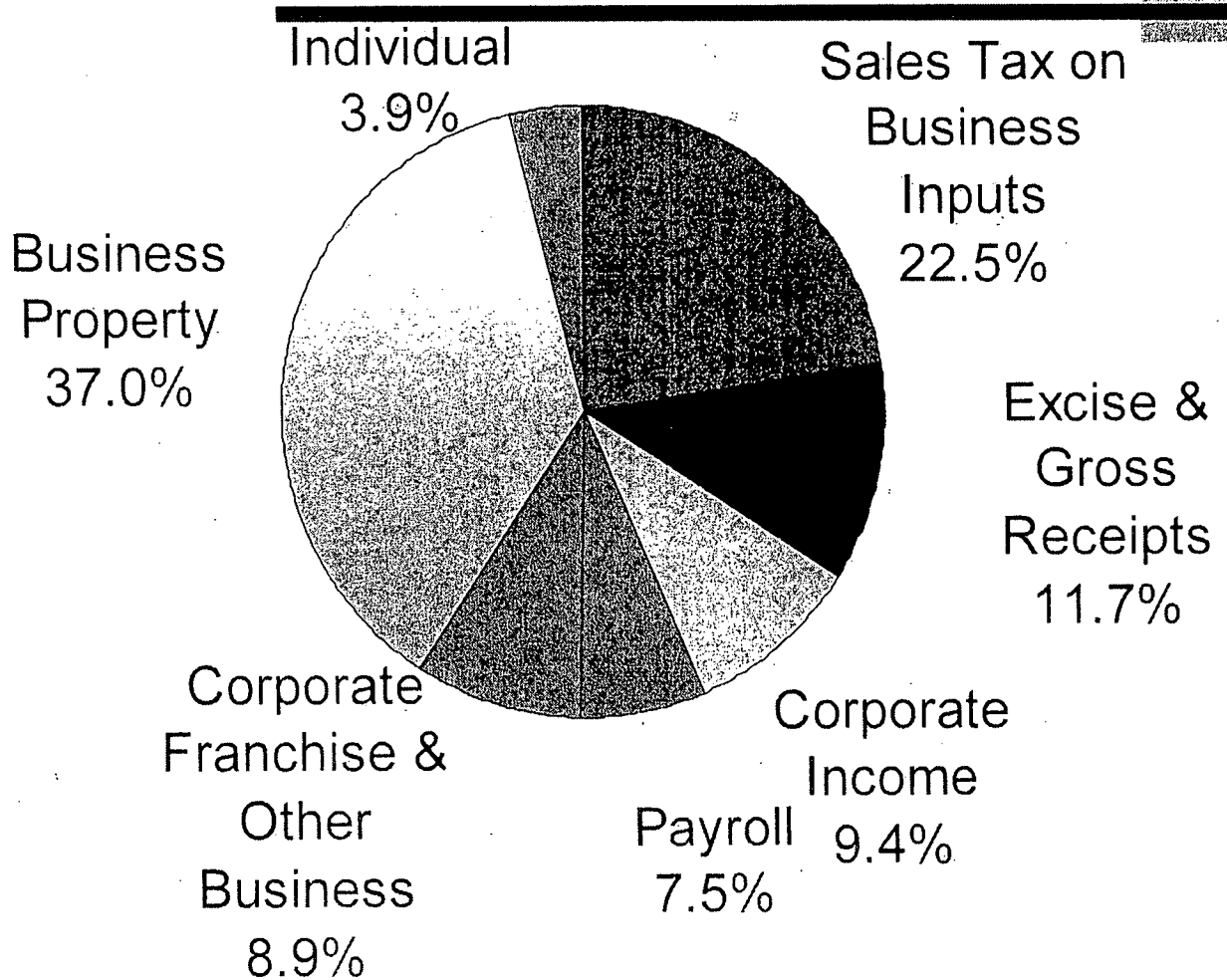
William F. Fox
The University of Tennessee

February 2008

THE UNIVERSITY of TENNESSEE
Center for Business and Economic Research

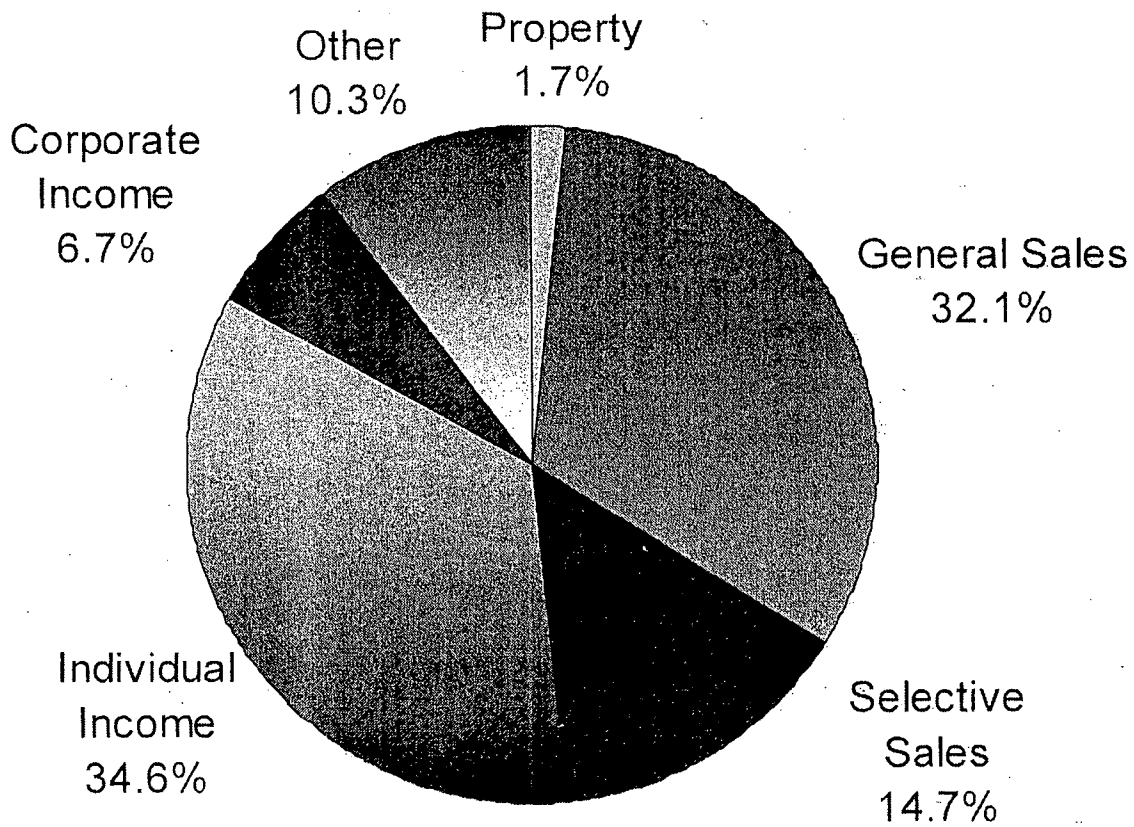
http://cber.bus.utk.edu

Businesses Pay Many Taxes, FY2006

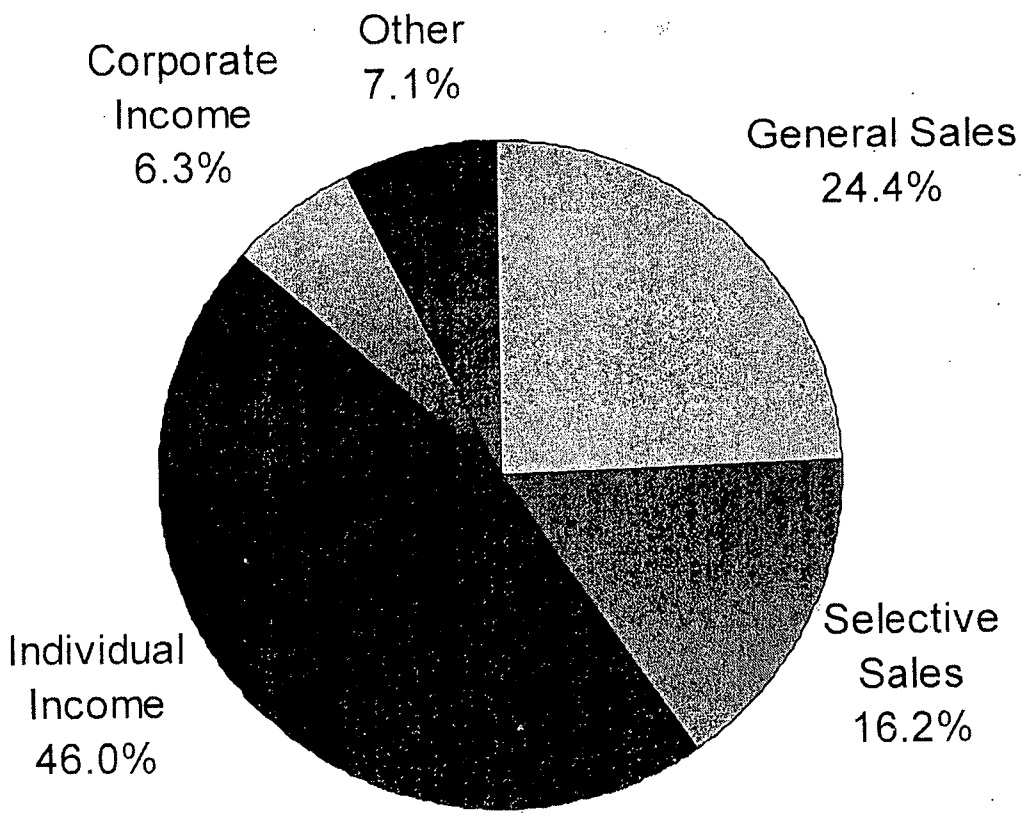


Ernst & Young, 2007

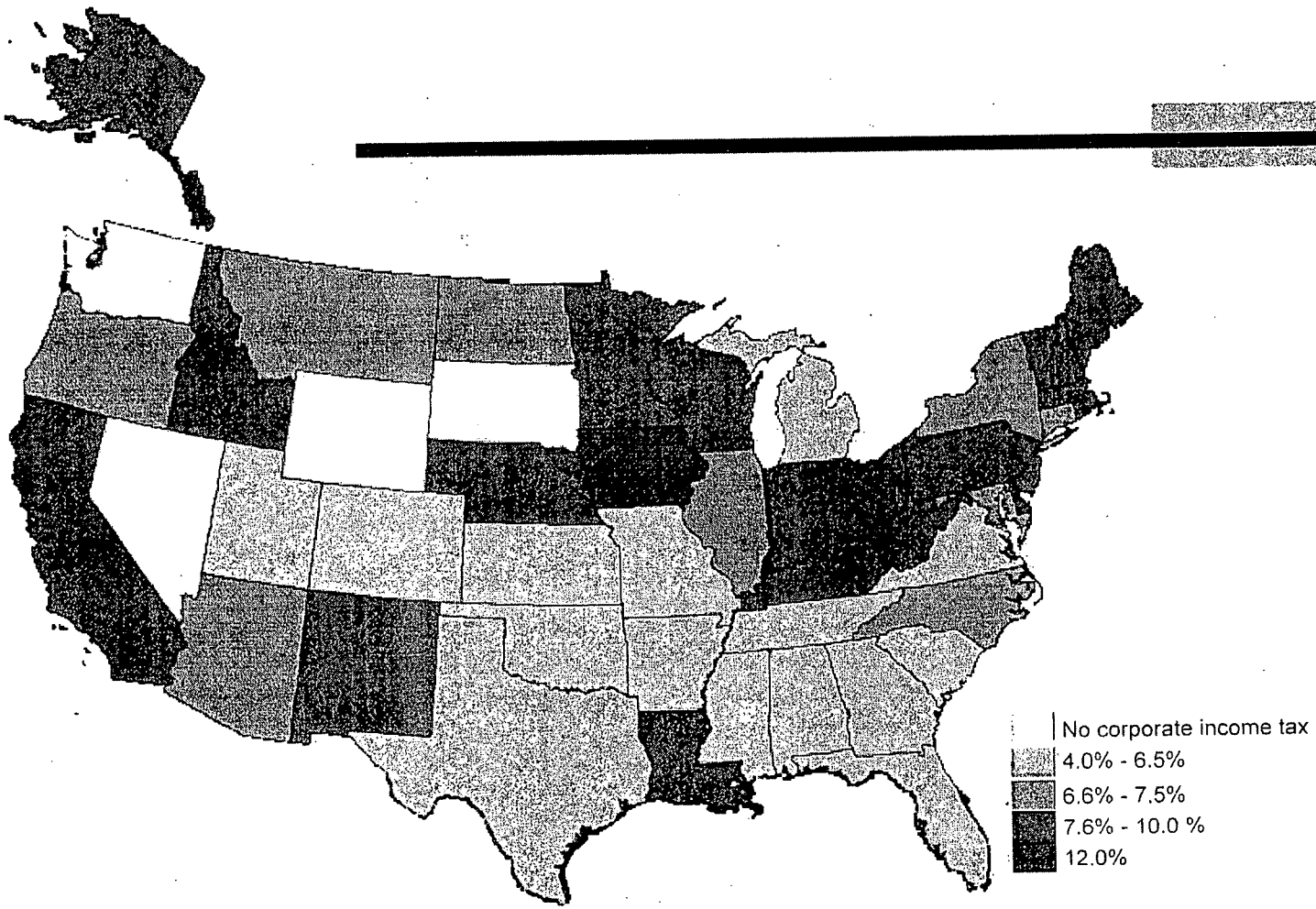
PERCENTAGE DISTRIBUTION OF U.S. STATE TAX COLLECTIONS, 2006



I. PERCENTAGE DISTRIBUTION OF NC STATE TAX COLLECTIONS, 2006



State Corporate Income Tax Rates



Source: Federation of Tax Administrators, March 2005.

Possible goals for taxing business

- Revenue
- Tax exporting
- Tax portfolio balance
- Revenue handles
- Benefit taxes

Benefit Taxes

- Tax businesses for their benefits to avoid cross subsidies from or to households and to properly distribute costs
- Corporate income taxes are a poor mechanism for taxing benefits
  - Benefit tax should be on all businesses, not just profitable corporations
  - Profits a poor proxy for benefits
  - Physical presence makes even worse

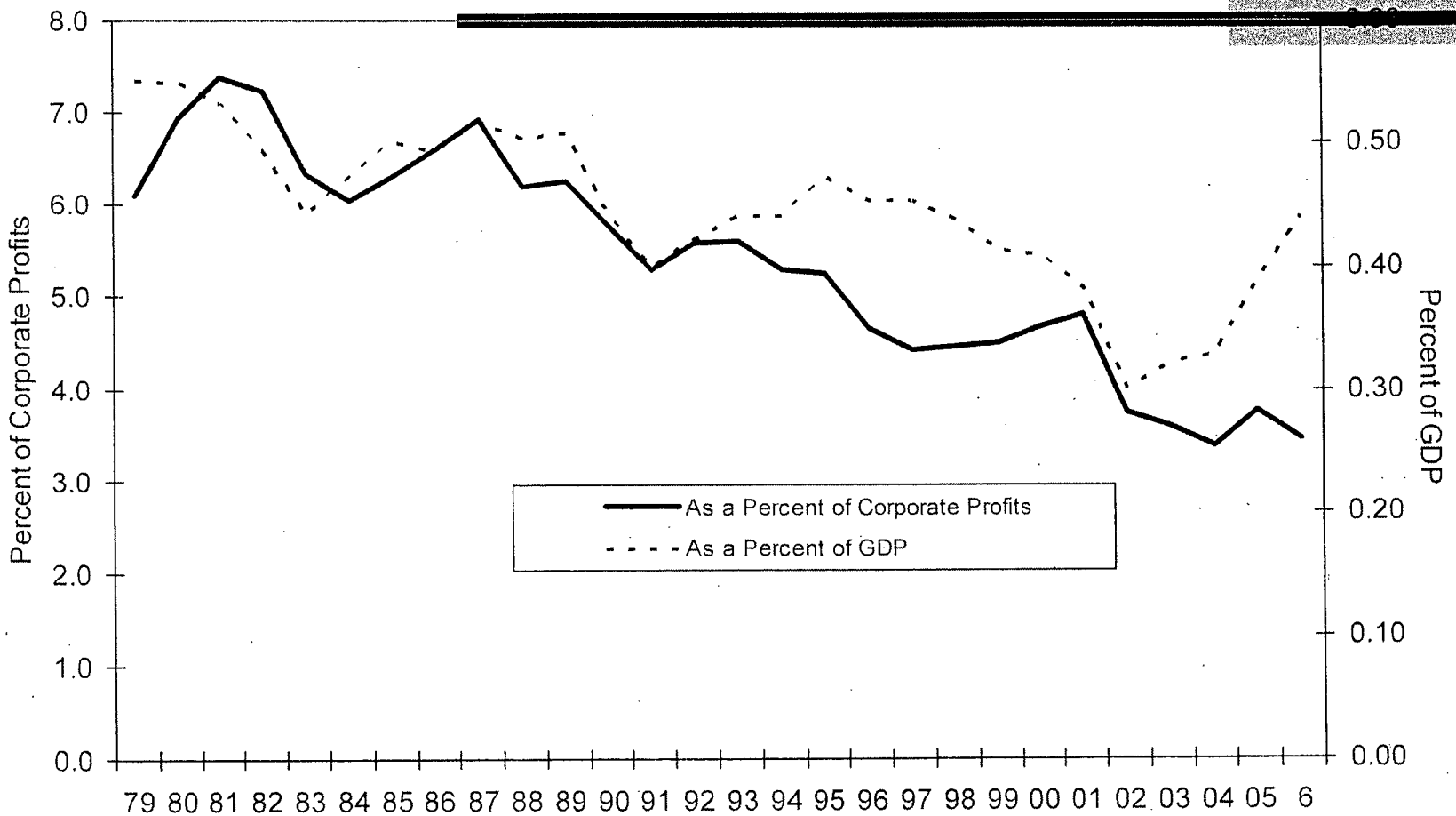
Some Alternatives for Taxing Business

- Corporate Income Tax
- Corporate Franchise Tax
- Value Added Tax –New Hampshire; Many economists prefer an origin VAT as the mechanism for state business taxation
- Texas Margins Tax
- Ohio CAT
- Michigan Business Tax
- Existing Gross Receipts Taxes – Washington
- Minimum Gross Receipts bases- KY, NJ

Why Reform State Corporate Income Taxes?

- Offset shrinking base

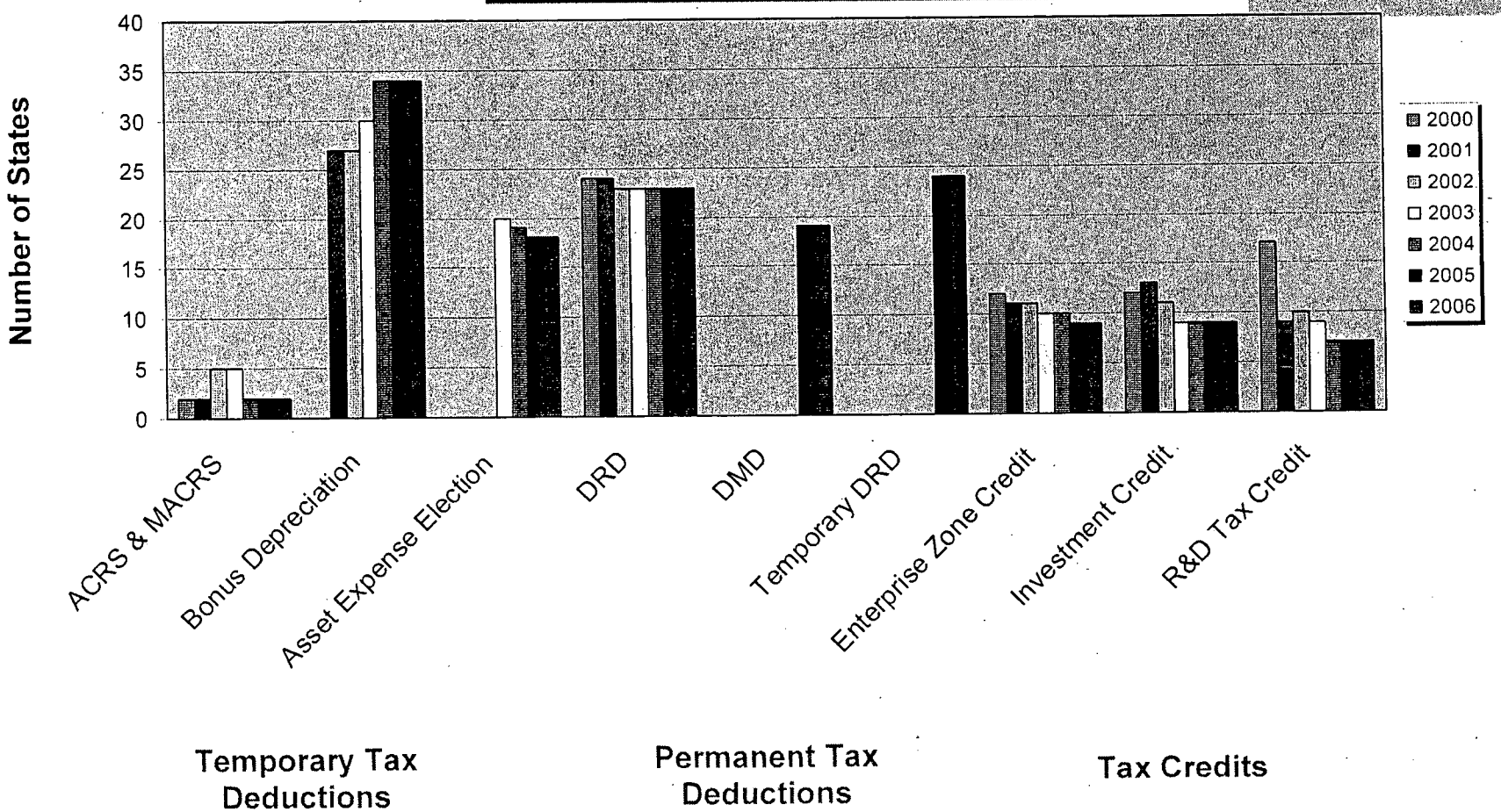
State Corporation Net Income and License Tax Base



Why has the corporate income tax base been shrinking?

- State policy decisions
  - Concessions
  - Greater weight on sales factor?
- Federal policy decisions
  - Accelerated depreciation
  - Production exemptions
  - Administration

Level of Decoupling by Provision by Year



Why has the corporate income tax base been shrinking?

- State policy decisions
  - Concessions
  - Greater weight on sales factor?
- Federal policy decisions
  - Accelerated depreciation
  - Production exemptions
  - Administration
- Tax planning
  - Transfer pricing and intangible holding companies
  - Corporate structure

State Approaches to Tax Planning and Entity Isolation

- Combined reporting – 21 states require, others allow

Combined Reporting

- Combine loss and profitable entities
- Limit transfer pricing for tangible goods
- Account for shared costs for overhead, mgt expertise
- Accounts for advantages of vertical integration

Issues with Combined Reporting

- What is a unitary business?
  - Combined Control?
  - Shared economies of scale/scope, vertical integration?
  - Are these relationships substantial?
- Which firms to combine?
  - International businesses?
  - Pass through entities?
  - Only ones with nexus?

State Approaches to Tax Planning and Entity Isolation

- Combined reporting – 21 states require, others allow
- Disallow/addback deductions between related companies - Massachusetts
- Economic nexus - Impose nexus on PICs – South Carolina
- Examine PIC for valid business purposes - Maryland
- Audit transfer prices
- Extend corporate taxes to unincorporated firms
- All will be incomplete

Why Reform State Corporate Income Taxes?

- Offset shrinking base
  - Reduce tax planning
- Broaden set of taxpayers
- Reduce tax on instate production - manufacturing

Other Business Taxes

- Could argue for eliminating business taxes, but unless that occurs, taxes on alternative bases may be best evaluated in the context of what they replace – generally the corporate income tax
- Well understood that gross receipts taxes are not effective tax instruments, but most discussions evaluate gross receipts taxes in context of a theoretically pure tax rather than the tax they are likely to replace
- Corporate income tax can be thought of as three taxes
  - Payroll
  - Property
  - Sales
- As move to greater sales weighting, the corporate income tax is a tax on gross receipts with the rate dependent on the profitability of the firm. But, the relative nature of the formula alters the arithmetic

Comparison of CIT and GRT

- Taxpayers
  - Unincorporated businesses
  - No PL86-272 constraint
  - Unprofitable firms
- Can add new incentives, depending on structure - Ohio
- Evasion/avoidance options –
  - Easier for CIT, and different incentives
  - Effects of marginal rate depends on profitability of company
  - No disincentive to sell out of state with GRT if situs on destination basis
  - But, some new incentives with GRT

Comparison of CIT and GRT

- Total tax liability depends on number of stages of production
  - Which causes greater distortions, a 6.5% corporate income tax or a 1.0% gross receipts tax
  - Distorts equity - cascading
  - Encourages vertical integration
  - Hurts transparency, but CIT?
- Differential burdens across firms
  - GRT likely to be larger burden relative to profits for low margin firms –differential effective rate by industry, but also true to some extent with the CIT

Comparison of CIT and GRT

- Administrative issues
  - Transition costs
  - GRT is an above the line tax
  - Issues of nexus and sourcing remain
  - Role of combined reporting
  - Complexity rises if both an income and alternative tax must be calculated, but otherwise probably not

Comparison of CIT and GRT

- Revenue Implications
  - GRT base is generally very broad, and can be expected to exceed gross product – Ohio is 1.26 times state GDP
  - Sizeable revenue potential, even with low rates (0.26% in Ohio)
  - More stable than the corporate income tax
  - Elasticity depends in part on tendency to enact future base erosion, or rate increases
- Are the GRT's a backdoor entry to a Single Business Tax?

FEBRUARY 2007

Total State and Local Business Taxes

50-State Estimates for FY2006

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Total State-Local Business Taxes

- Study initially answered question: "Are businesses paying their 'fair' share of state and local business taxes?"
- The focus has shifted from issue of businesses paying their "fair" share of taxes to concern over the impact of state and local business taxes on economic competitiveness
- More states adopting or considering significant changes in business tax systems to improve competitiveness
- Much of the tax policy discussion talks about the corporate income tax as if it was the only business tax

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Narrow Focus on the Corporate Income Tax

- Focus on the corporate income tax fails to consider the broader picture of combined state-local business taxes:
  - property taxes on business property
  - sales and excise taxes on business inputs and equipment
  - corporate income and franchise taxes, capital stock taxes
  - gross receipts taxes (e.g., utilities and insurance)
  - unemployment insurance taxes, and
  - business license taxes
- The E&Y/COST study presents detailed state-by-state analysis of total state-local business taxes.

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Total U.S. State and Local Business Taxes

- U.S. businesses paid $554 billion in state-local taxes in FY06.
- Business taxes account for 45% of total taxes collected by state and local governments.
- Corporate income taxes account for only 9% of total U.S. state and local business taxes.
- Non-income taxes account for 90% of business taxes.
  - Property taxes account for 39%
  - Sales tax on business inputs and investments, 25%

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US State & Local Business Taxes FY06 ($bil)

Business Tax	FY2002	FY2006	%Chg
Property taxes on business property	$149.7	$204.8	36.8%
General sales taxes on business inputs	$97.5	$124.7	28.0%
Corporate income tax	$29.5	$51.8	75.5%
Unemployment Insurance	$21.0	$36.4	73.7%
Other business taxes	$16.8	$27.0	60.9%
Excise taxes	$20.6	$25.7	24.8%
Public utility taxes	$18.4	$24.5	33.1%
Corporate and business license	$17.3	$22.4	29.7%
Individual income tax on business Income	$14.6	$21.4	46.9%
Insurance premiums	$11.0	$14.8	34.2%
Total Business Taxes	**$396.4**	**$553.7**	**39.7%**

Source: EY Calculations

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State-Local Gross Receipts Taxes (FY06)

- Estimates of GRTs from 50-state business tax study
- GRTs would account for 12% of state-local business taxes, assuming OH, TX, MI laws fully phased in

General gross receipts taxes	$6b
Insurance premiums taxes	$15b
Public utility GRTs	$23b
Occupation/bus. licenses	$18b
Other GRTs	$4b
Total	$66b

- Compared to $50 billion in corporate income taxes (adjusted for new taxes) and $125 billion in sales taxes on business inputs (should be zero, in theory)

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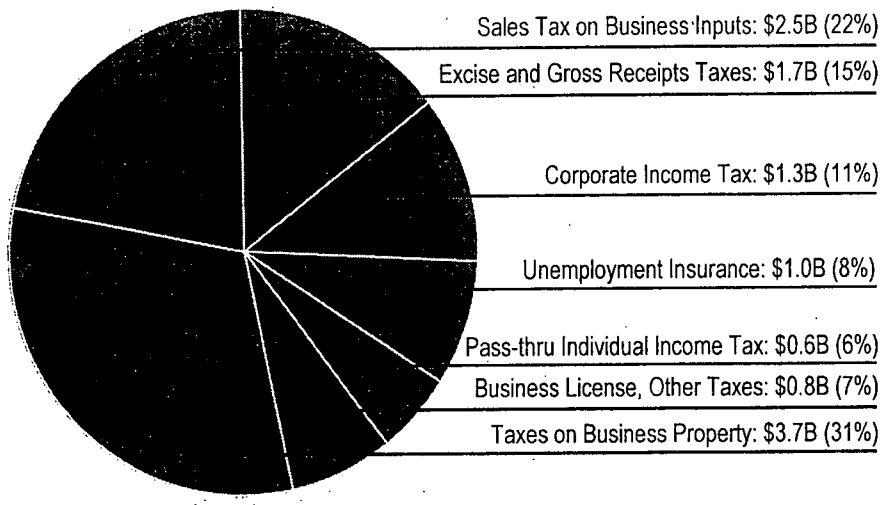
NC Total State & Local Business Taxes, FY06

- North Carolina businesses paid $11.7 billion in state and local taxes in FY06.
- NC business taxes account for 37% of total state and local tax collections, compared to 45% nationwide
- Corporate income taxes account for only 11% of total state and local business taxes.
- Non-income taxes account for nearly 90% of business taxes.
  - Property taxes, 31%
  - Sales tax on business inputs and investments, 22%

Composition of NC Business Taxes, FY06



NC Business Taxes, FY02-FY06 ($mil)

Business Tax	FY2002	FY2006	%Chg
Property taxes on business property	$2,648	$3,662	38%
Sales and use tax on business inputs	1,900	2,538	34%
Corporate income tax	763	1,308	71%
Unemployment insurance	365	974	167%
Excise taxes	781	933	20%
Individual income tax on bus. income	407	353	44%
Business and corporate license	388	526	36%
Insurance premiums tax	444	639	27%
Public utility taxes	348	442	-13%
Other business taxes	212	308	45%
Total State and Local Business Taxes	$8,256	$11,683	**42%**

Source: EY Calculations

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Total Business Taxes & Competitiveness

- The business tax share indicates how heavily a state relies on taxes paid by business, but provides limited information about competitiveness.
- A state's competitiveness depends on the level of business taxes and the ability of taxpayers to shift taxes to factors of production.
- Business taxes relative to economic activity (GSP) provides a starting point for comparing business tax burdens across states.

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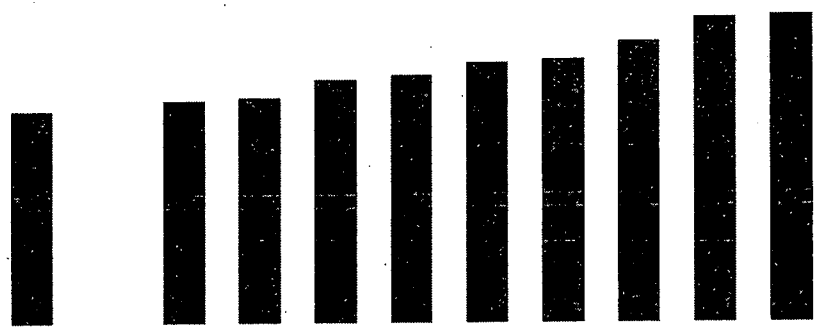
Regional Business Shares of Total Taxes



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Business Taxes as a % of Value Added

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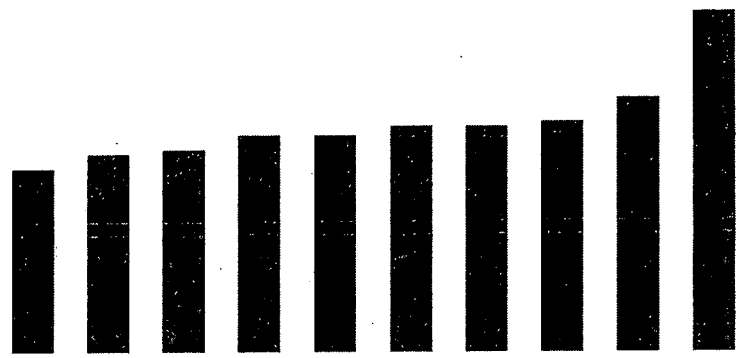
Regional Effective Tax Rates on Value-Added



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Reducing Business Taxes on Capital

- Business taxes fall heavily on capital – property, income and net worth taxes, sales taxes on business purchases
- Problem of *origin-based* taxes:
  - Property taxes are 3 times higher than corporate income taxes
  - Sales taxes on business purchases are, in effect, origin-based taxes if passed forward in higher prices to purchasers
- Other state are:
  - Reducing taxes on mobile capital and shifting from origin to destination tax systems: lower TPP taxes, 100% sales factor apportionment formulas, elimination of corporate income taxes
  - Changing perspective from *ability-to-pay* (profits) to *benefits received* justifications for business taxes

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Framing the Right Tax Policy Questions

- Understand that state and local taxes are a system of taxes on income, capital and consumption. The combined impact is what is drives business decisions.
- Important first step in determining the economic incidence of business taxes
  - How much falls on resident and non-resident consumers, resident and non-resident capital owners, and on resident workers and landowners?
  - How much effect on the location decisions of multi-state firms?
- Provide a framework for evaluating business taxes in terms of tax policy principles. Do businesses consume 37% of NC govt services? How much net tax paid?

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TAX SERVICES

FEBRUARY 2007

Total State and Local Business Taxes

By Robert Cline, Tom Neubig, and Andrew Phillips, Ernst & Young LLP
Prepared in conjunction with the Council On State Taxation

COST
COUNCIL ON STATE TAXATION

ERNST & YOUNG
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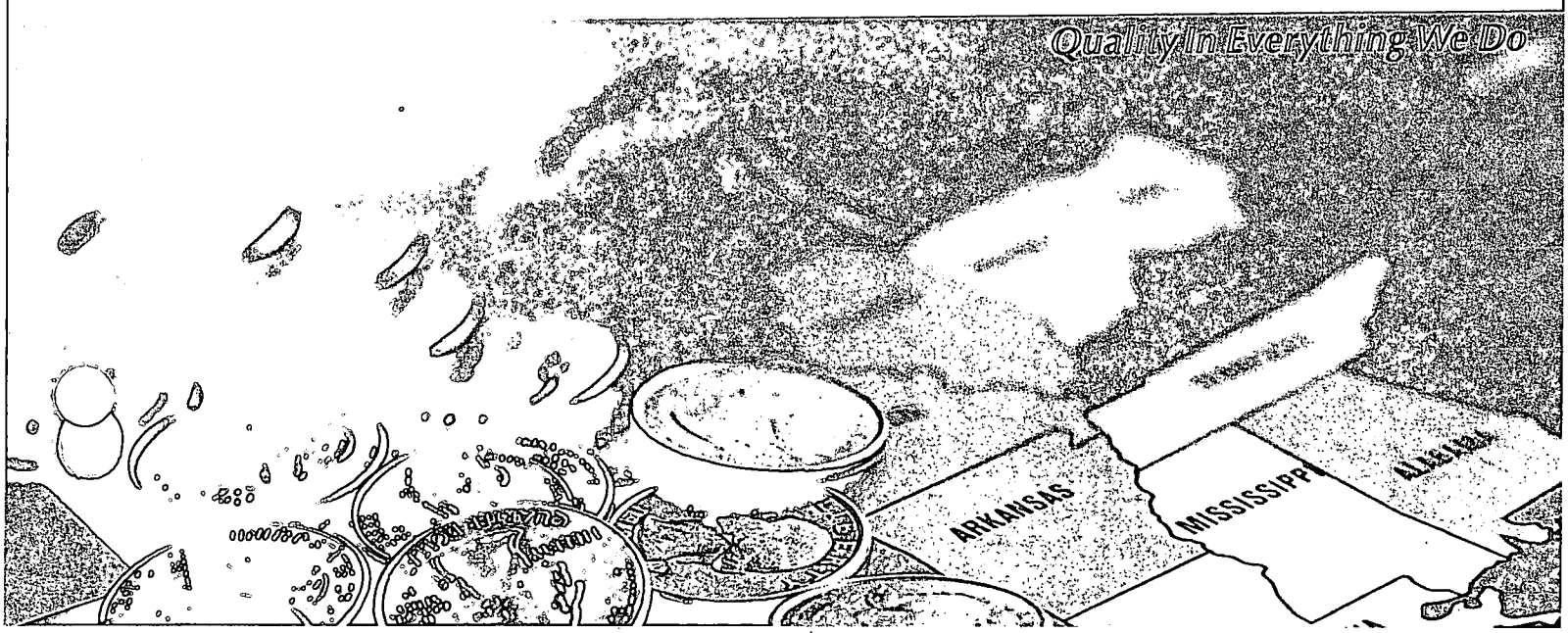
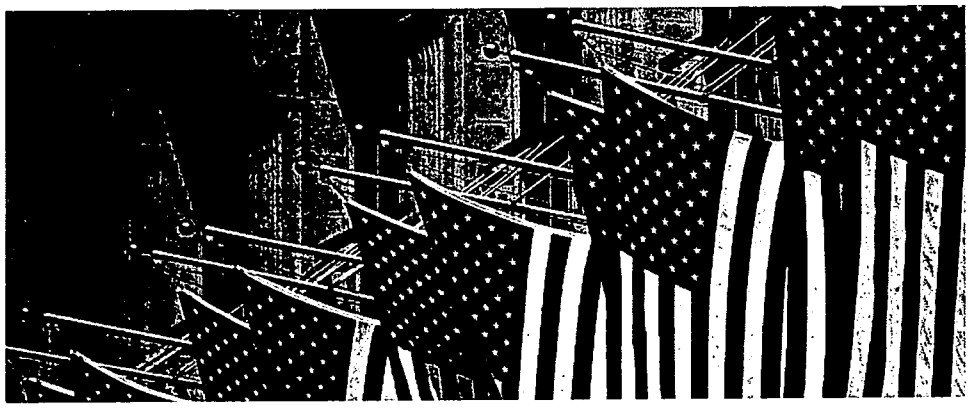


Executive Summary



This is the fifth annual report prepared by Ernst & Young in conjunction with the Council On State Taxation (COST) that provides detailed state-by-state estimates of state and local taxes paid by business. This study includes estimates for FY2006.[1]

In FY 2006, businesses paid $554 billion of state and local taxes, and business taxes accounted for 45% of total taxes collected by all state and local governments in the United States. Information presented in this study will help answer tax policy questions currently being debated in state legislatures: "How much tax do businesses pay?" and "Are our current state and local business taxes adversely affecting our state's economic competitiveness?"

This study includes estimates of total state and local taxes paid by businesses in each state. The analysis examines business property taxes, sales and excise taxes paid by businesses on their input purchases, gross receipts taxes, corporate income and franchise taxes, business and corporate license taxes, unemployment payroll taxes, the individual income taxes paid by owners of non-corporate (pass-through) businesses, and other state and local taxes that are the statutory liability of business taxpayers.

Are current state and local business taxes adversely affecting states' economic competitiveness?

The state-by-state estimates indicate significant variation in the share of state and local taxes paid by businesses across the states. The share of state and local taxes paid by businesses is determined by a state's overall tax system, the structure of its economy, the types of business taxes levied, as well as business tax features that may provide a competitive advantage or disadvantage in attracting and retaining business employment and investment in the state.

Key findings of the study include:

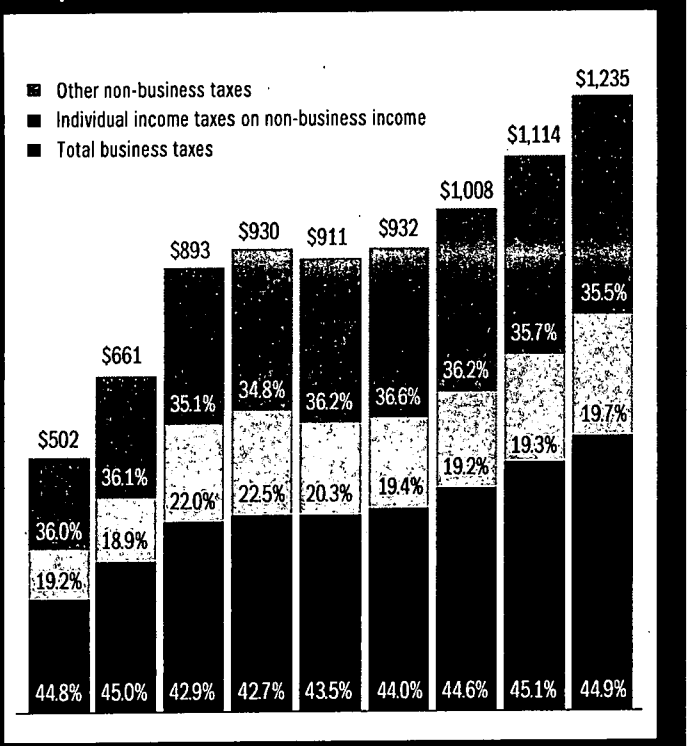
- State and local business taxes increased by 10.2% to $554 billion in FY2006.
- Over the last four years, state and local taxes on business have risen faster than total state and local taxes. As a result, businesses paid 49% of the *additional* state and local taxes collected from FY2002 to FY2006.
- Businesses paid more than half of the total four-year increase in state and local taxes in 27 states. At the state level, business tax growth accounted for more than half of the tax increase in 22 states and averaged 45% for all states. At the local level, business tax growth was stronger, generating more than half of the four-year increase in 41 states and averaging 54% of total U.S. local tax growth.
- Property taxes on business property totaled $205 billion in FY2006, equal to 37% of total state and local business taxes. Sales and use taxes on business inputs and capital equipment totaled $125 billion, nearly 23% of business taxes. The property tax and a significant portion of sales taxes paid by businesses are taxes on capital invested within a state.
- The composition of total state and local business taxes paid varies by industry, with manufacturing and transportation continuing to pay significant property taxes and sales taxes on business purchases. Traditionally, regulated businesses have been subject to significant industry-specific excise and gross receipts taxes.

Total State and Local Business Taxes from 1980 to 2006

Total state and local business taxes grew from $230 billion in 1990 to $283 billion in 2000 and to more than $554 billion in FY2006. Figure 1 shows the composition of total state and local taxes, split between business taxes and non-business taxes.[4] Businesses paid 44.9% of total state and local taxes in 2006, nearly the same share businesses paid in 1990. Over the last five years, the business share has averaged 44.4%.

Appendix Table A-1 presents the level and composition of state and local business and non-business taxes from 1980 through 2006. Appendix Table A-2 shows business taxes by tax type for the same period. Since 1980, the corporate income tax has declined as a share of total state and local business taxes, while the shares of business license taxes and individual income taxes on pass-through income have increased.

FIGURE 1 Composition of State and Local Taxes, 1980-2005 (Dollars in Billions)



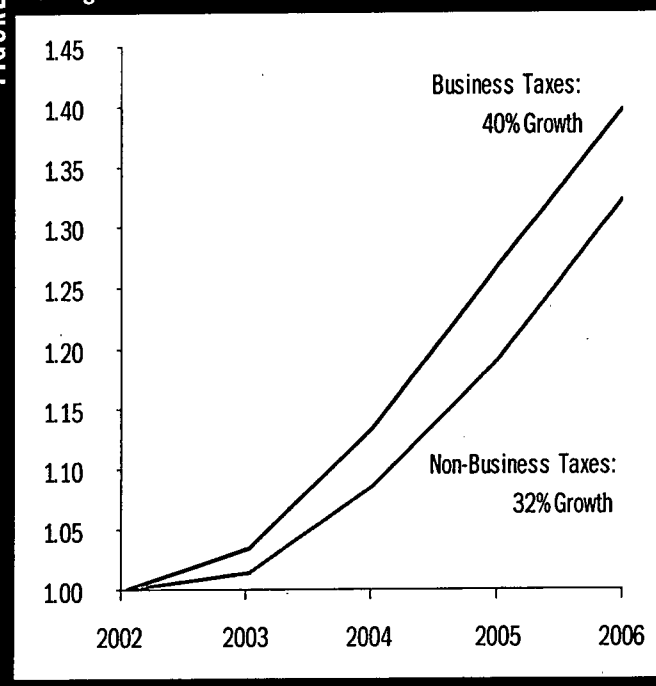
Recent Trends in State and Local Taxes

Business Taxes Are Growing Faster Than Non-Business Taxes

Total state and local business taxes increased by nearly 40%, or more than $157 billion, between FY2002 and FY2006. As shown in Figure 2 and Table 2, the cumulative growth in business taxes during this period exceeded the cumulative growth of non-business taxes by more than 7 percentage points. The growth of total business taxes over this period resulted from increases in most business taxes, including rapidly growing corporate income (+76%) and unemployment insurance taxes (+74%) and above-average growth of property taxes (+37%), the largest component of state and local business taxes.

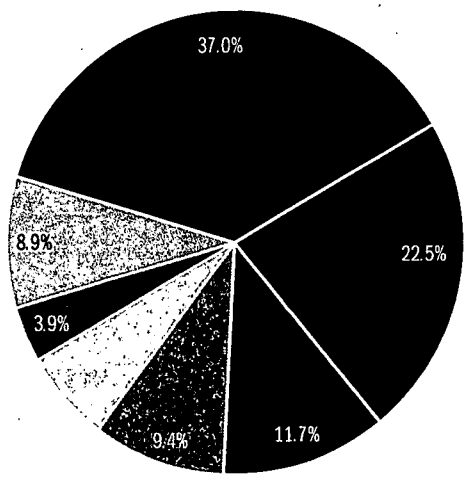
In addition to being the largest component of state and local business taxes, property tax accounted for 35% of the total business tax increase between FY2002 and FY2006. The growth rate of property taxes accelerated over the past three years. Since 2003, the property tax has increased at an average annual rate of 10%, after averaging less than 4% growth from 2001 through 2003. Tempering the growth of real property taxes are repeals or reductions in personal property taxes and reductions in business property tax rates in several states.

FIGURE 2 Change in State and Local Business Taxes, FY2002 to FY2006



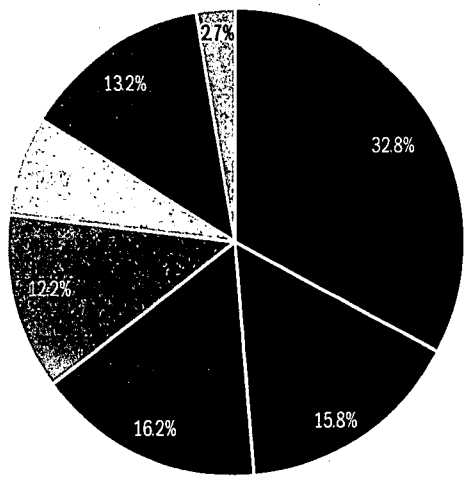
(FY2002 Amounts=1.0)

FIGURE 3



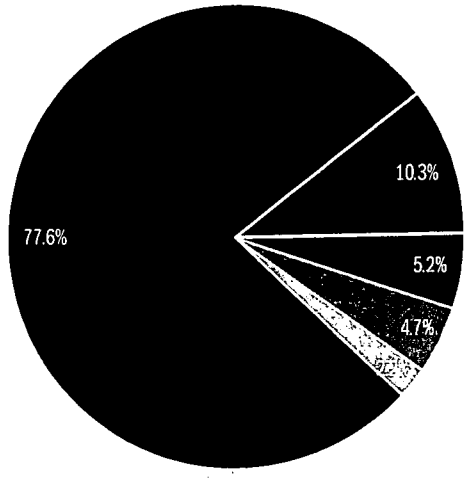
State and Local Business Taxes

- Property taxes on business property
- Sales and use tax on business inputs
- Excise and gross receipts taxes
- Corporate income tax
- Unemployment insurance tax
- Individual income tax on business income
- Business license and other business taxes



State Taxes

- Sales and use tax on business inputs
- Excise and gross receipts taxes
- Corporate income tax
- Unemployment insurance tax
- Individual income tax on business income
- Business license and other business taxes
- Property taxes on business property



Local Taxes (County, City, School, Special Districts)

- Property taxes on business property
- Sales and use tax on business inputs
- Other business taxes
- Public utility taxes
- Excise taxes

State-by-State Business Tax Estimates

Origin-based taxes, such as the property tax and sales tax on business inputs, influence business location decisions and vary significantly from state to state.

This section presents state and local business taxes by type of tax for each of the 50 states plus the District of Columbia. Table 4 presents the different business taxes by state. Origin-based taxes, such as the property tax and sales tax on business input purchases, which are more important in businesses' location decisions than destination-based taxes, vary significantly as a share of total business tax. Indiana, Arizona, and Texas generate more than 70% of business taxes from the sales and property taxes, resulting in significant taxes on business capital located in the state.

Table 5 presents business taxes as a percentage of total, state, and local taxes by state. The business share of total state and local taxes will depend on many factors, including a state's reliance on individual income taxes and general sales taxes and the level and type of business activity in the state. The business share of total taxes averages nearly 45% nationally but ranges from 34% in Connecticut to 82% in Alaska.

The business share of total taxes indicates how heavily state and local tax systems rely on taxes that are liabilities of businesses instead of households. However, this measure provides limited information about the competitiveness of a state's business tax system compared to other states. A state's competitiveness depends on the level of business taxes compared to the level of economic activity that is being taxed and the final incidence of business taxes, after they have been shifted to consumers or factors of production. Because state business tax bases include a diverse mixture of receipts, net income, input purchases, payroll, property, and other tax bases, a broad measure of a state's overall economic activity should be used to determine an aggregate business tax burden that can be compared across states.

The last column in Table 5 presents a state-by-state measure of the effective business state and local tax rate (ETR). The ETRs are measured as the ratio of state and local business taxes to private-sector gross state product (GSP), the total value of a state's annual production of goods and services, excluding the public sector. The average ETR across all states is 5.1%; ETRs range from 3.7% in D.C. to 10.9% in Wyoming.

While the business ETRs provide a starting point for comparing burdens across states, they do not provide sufficient information to fully evaluate a state's competitiveness. For example, Wyoming's ETR of 10.9% is due to severance taxes that are not taxes on mobile capital. More generally, a state with an average overall ETR may impose relatively high taxes on capital-intensive manufacturers while imposing relatively low taxes on labor-intensive service industries. As a result, this state's tax structure and composition may create disincentives for locating new plant and equipment in the state and hinder economic growth. State legislators and policymakers need to look more closely at the structure and composition of business taxes and the composition of economic activities in evaluating their state's business tax competitiveness.

TABLE 5

Business Taxes as a Share of State, Local, and Total Taxes and Private Sector GSP, FY2006 *(Dollars in Billions)*

State	STATE			LOCAL			STATE and LOCAL			
	Business	Total	Business Share	Business	Total	Business Share	Business	Total	Business Share	Percent of GSP
Alabama	$3.6	$8.6	42.2%	$1.9	$3.8	48.9%	$5.5	$12.4	44.2%	4.3%
Alaska	2.3	2.5	92.7	0.8	1.4	62.3	3.1	3.9	82.1	9.8
Arizona	5.1	11.9	43.1	4.7	8.1	58.6	9.8	20.0	49.4	5.2
Arkansas	2.7	7.1	37.3	0.9	1.5	58.2	3.6	8.6	40.9	4.7
California	47.4	118.4	40.0	27.9	59.5	46.9	75.3	177.9	42.3	5.2
Colorado	3.3	9.1	35.9	4.8	9.0	53.1	8.1	18.1	44.4	4.2
Connecticut	4.1	12.7	32.5	2.8	7.4	37.6	6.9	20.1	34.3	3.9
Delaware	1.7	3.1	55.7	0.3	0.7	43.4	2.0	3.8	53.5	3.9
Florida	17.3	41.0	42.3	14.7	26.0	56.5	32.0	67.0	47.8	5.4
Georgia	5.9	17.9	33.0	7.3	14.1	51.9	13.2	32.0	41.3	4.2
Hawaii	1.6	5.1	31.2	0.8	1.1	69.6	2.4	6.2	38.0	5.6
Idaho	1.1	3.3	32.9	0.8	1.3	62.6	1.9	4.6	41.2	4.6
Illinois	13.2	30.0	44.1	13.5	26.0	51.8	26.7	56.0	47.7	5.3
Indiana	4.3	14.2	30.3	6.2	8.7	70.4	10.5	22.9	45.6	4.9
Iowa	1.8	5.6	31.3	2.8	4.2	66.8	4.6	9.8	46.6	4.6
Kansas	2.5	6.6	38.4	2.8	4.3	64.2	5.3	10.9	48.6	5.8
Kentucky	4.4	9.8	44.8	1.5	3.5	44.4	5.9	13.3	44.7	4.9
Louisiana	4.3	8.4	51.0	4.6	6.3	73.4	8.9	14.7	60.6	6.0
Maine	1.1	3.6	31.8	1.4	2.0	70.7	2.5	5.6	45.6	6.6
Maryland	4.9	14.6	33.5	4.5	11.3	39.5	9.4	25.9	36.1	4.6
Massachusetts	7.0	21.2	33.0	6.1	12.6	48.3	13.1	33.8	38.7	4.4
Michigan	9.5	26.0	36.5	6.3	11.6	53.9	15.8	37.6	41.9	4.7
Minnesota	6.7	18.3	36.7	4.1	7.2	56.9	10.8	25.5	42.5	5.1
Mississippi	2.4	6.1	38.8	1.7	2.4	72.6	4.1	8.5	48.3	6.1
Missouri	3.7	10.8	34.0	4.1	8.0	51.1	7.8	18.8	41.3	4.1
Montana	1.0	2.2	44.2	0.6	0.9	66.2	1.6	3.1	50.9	6.3
Nebraska	1.6	4.1	37.9	1.9	3.1	59.8	3.5	7.2	47.4	5.7
Nevada	2.9	6.5	44.4	1.8	3.5	52.9	4.7	10.0	47.4	4.7
New Hampshire	1.3	2.2	60.7	1.2	2.3	53.3	2.5	4.5	56.9	5.1
New Jersey	11.0	28.6	38.6	7.6	19.9	38.1	18.6	48.5	38.4	4.8
New Mexico	2.6	4.5	57.2	0.9	1.6	54.5	3.5	6.1	56.5	6.2
New York	19.4	58.5	33.3	31.1	59.3	52.5	50.5	117.8	43.0	5.9
North Carolina	7.2	21.6	33.4	4.5	9.7	46.1	11.7	31.3	37.4	3.9
North Dakota	1.0	1.7	57.2	0.6	0.8	70.6	1.6	2.5	61.5	7.3
Ohio	9.3	25.9	35.9	9.1	19.6	46.2	18.4	45.5	40.3	4.7
Oklahoma	3.7	8.1	45.9	2.0	3.5	58.0	5.7	11.6	49.5	5.6
Oregon	2.2	8.3	27.1	2.6	5.1	50.6	4.8	13.4	36.1	3.9
Pennsylvania	13.6	31.7	42.8	8.4	20.0	42.0	22.0	51.7	42.5	5.0
Rhode Island	1.2	3.1	40.8	1.0	1.8	54.8	2.2	4.9	46.0	5.8
South Carolina	2.5	8.4	29.8	3.1	5.0	62.7	5.6	13.4	42.1	4.8
South Dakota	0.7	1.2	55.3	0.8	1.1	73.8	1.5	2.3	64.0	5.4
Tennessee	5.4	11.2	48.5	3.9	6.8	56.9	9.3	18.0	51.7	4.6
Texas	23.1	37.9	61.0	26.3	40.4	65.2	49.4	78.3	63.1	5.6
Utah	1.9	5.7	33.0	1.4	2.8	48.1	3.3	8.5	38.0	4.2
Vermont	1.0	2.3	43.1	0.3	0.5	58.7	1.3	2.8	45.8	6.5
Virginia	4.7	17.7	26.4	6.6	12.2	54.4	11.3	29.9	37.8	3.9
Washington	9.7	17.6	55.1	4.5	9.3	48.8	14.2	26.9	52.9	6.2
West Virginia	2.1	4.7	44.3	1.1	1.4	79.1	3.2	6.1	52.2	7.2
Wisconsin	5.2	15.1	34.6	4.4	9.4	46.9	9.6	24.5	39.3	5.0
Wyoming	1.9	2.3	79.3	0.7	1.0	71.7	2.6	3.3	77.0	10.8
Dist. of Columbia	2.0	4.5	43.9	0.0	0.0	0.0	2.0	4.5	43.9	3.7
United States	**$300.1**	**$751.5**	**39.9%**	**$253.6**	**$483.0**	**52.5%**	**$553.7**	**$1,234.5**	**44.9%**	**5.1%**

**Percent of 2005 private-sector GSP equivalent to an effective tax rate on economic activity occurring within the state. Amounts may appear not to sum due to rounding. Source: EY Calculations*

TABLE 6

Change in State and Local Business Taxes, FY2002 to FY2006 *(Dollars in Billions)*

State	Total State and Local Business Taxes				Total State and Local Taxes		Business Share of Tax Revenue Growth
	FY2002	FY2006	$ Change	% Change	$ Change	% Change	
Alabama	$3.9	$5.5	$1.6	39.2%	$3.1	32.6%	50.7%
Alaska	1.7	3.2	1.5	88.7	1.7	76.8	88.8
Arizona	7.1	9.9	2.8	39.9	5.5	37.6	51.6
Arkansas	2.6	3.5	0.9	36.0	2.3	36.6	40.3
California	52.0	75.3	23.3	44.8	54.8	44.5	42.5
Colorado	5.7	8.0	2.3	41.1	4.4	32.2	53.1
Connecticut	5.1	6.9	1.8	34.7	5.3	36.1	33.3
Delaware	1.5	2.0	0.5	34.1	1.0	37.3	50.1
Florida	20.6	32.0	11.4	55.0	22.6	50.9	50.3
Georgia	9.5	13.2	3.7	39.0	7.8	32.3	47.5
Hawaii	1.6	2.3	0.7	43.2	1.8	42.9	38.2
Idaho	1.4	1.9	0.5	32.1	0.8	22.0	55.4
Illinois	19.5	26.7	7.2	36.8	13.5	31.8	53.2
Indiana	7.5	10.5	3.0	39.7	6.1	36.2	48.8
Iowa	3.7	4.6	0.9	25.9	1.6	19.2	59.3
Kansas	3.7	5.3	1.6	42.4	2.8	34.2	56.8
Kentucky	4.4	5.9	1.5	34.4	2.4	21.7	64.3
Louisiana	7.1	8.9	1.8	24.5	2.5	20.7	69.6
Maine	1.9	2.5	0.6	37.0	1.4	33.0	49.7
Maryland	6.9	9.4	2.5	35.7	5.8	28.5	42.8
Massachusetts	8.9	13.1	4.2	46.8	9.1	36.7	46.0
Michigan	12.9	15.7	2.8	22.0	6.1	19.5	46.3
Minnesota	7.1	10.8	3.7	52.5	7.0	37.6	53.4
Mississippi	3.3	4.1	0.8	26.1	1.6	22.4	54.6
Missouri	5.9	7.8	1.9	31.1	3.8	25.6	48.0
Montana	1.1	1.6	0.5	47.7	0.9	42.8	54.8
Nebraska	2.5	3.4	0.9	39.8	1.9	35.8	51.1
Nevada	3.0	4.7	1.7	59.8	3.7	60.0	47.3
New Hampshire	2.0	2.6	0.6	29.6	0.9	25.6	63.8
New Jersey	12.8	18.6	5.8	46.0	14.6	42.8	40.3
New Mexico	2.9	3.5	0.6	20.8	0.9	16.1	70.0
New York	37.6	50.6	13.0	34.4	29.0	32.6	44.7
North Carolina	8.3	11.7	3.4	41.5	8.3	35.8	41.5
North Dakota	1.0	1.5	0.5	54.7	0.7	42.5	72.8
Ohio	13.9	18.3	4.4	31.7	9.8	27.4	45.1
Oklahoma	3.8	5.8	2.0	50.4	3.0	34.6	64.6
Oregon	3.3	4.8	1.5	45.6	4.0	43.0	37.5
Pennsylvania	15.6	22.0	6.4	41.0	12.9	33.3	49.4
Rhode Island	1.5	2.2	0.7	47.1	1.3	36.2	55.5
South Carolina	4.1	5.7	1.6	37.8	3.9	40.7	39.9
South Dakota	1.1	1.5	0.4	34.8	0.5	30.1	71.3
Tennessee	6.6	9.3	2.7	41.0	4.9	36.9	55.7
Texas	36.1	49.4	13.3	36.8	19.1	32.2	69.8
Utah	2.1	3.2	1.1	54.6	2.5	41.3	45.9
Vermont	0.8	1.3	0.5	60.2	1.0	53.6	49.4
Virginia	8.0	11.3	3.3	42.0	8.0	36.8	41.6
Washington	10.8	14.2	3.4	31.4	6.5	31.7	52.5
West Virginia	2.3	3.2	0.9	36.5	1.4	29.5	61.3
Wisconsin	6.9	9.7	2.8	40.3	6.5	35.9	42.8
Wyoming	1.3	2.6	1.3	102.5	1.5	80.5	87.4
Dist. of Columbia	1.6	2.0	0.4	26.5	1.2	37.1	34.0
United States	**$396.5**	**$553.7**	**$157.1**	**39.7%**	**$323.5**	**35.5%**	**48.6%**

**Note: $0.0 indicates a value less than $50 million.*

Amounts may appear not to sum due to rounding.

Source: EY Calculation

Table 8 presents a comparison of the composition of total state and local business taxes by major industry group. The figures show, for example, that excise and gross receipts taxes account for the largest share of the telecommunications industry's taxes while property taxes account for more than 40% of state and local taxes for utilities, nondurable manufacturing, transportation, and real estate. In formulating tax policy, the composition of business taxes should also be examined, considering the impact of taxes on business capital and the effect those taxes may have on the ability to retain and attract jobs and new investments.

TABLE 8

Composition of Total State and Local Business Tax by Industry, FY2006 *(Percentage of Total Business Taxes Paid by Industry)*

Industry	Property Taxes	General Sales Taxes on Business Inputs	Excise and Gross Receipts	Corporate Income Tax	Business License and Other Taxes	Payroll Taxes	Individual Income Tax (on Pass-Through Business Income)	Total Business Taxes
Utilities	44.5%	7.9%	41.0%	2.3%	3.5%	0.6%	0.0%	100%
Manufacturing	35.9	26.3	0.2	19.7	5.9	11.6	0.4	100
Non-Durable	39.7	26.7	0.5	16.7	7.3	8.8	0.4	100
Durable	33.1	26.0	0.0	21.9	4.8	13.7	0.4	100
Wholesale trade	20.8	24.3	35.1	7.5	6.8	4.6	0.9	100
Retail trade*	23.3	33.6	10.6	11.8	6.2	12.3	2.2	100
Transportation	43.2	32.1	5.5	2.9	6.3	6.2	3.8	100
Communications	26.6	26.0	28.8	10.2	5.5	2.2	0.8	100
Finance and Insurance	26.4	19.9	24.6	16.0	8.2	2.8	2.3	100
Real Estate	91.3	2.1	0.0	1.1	2.4	0.7	2.4	100
Management of Companies	3.9	3.1	0.0	54.6	35.8	0.4	2.1	100
Services	24.0	28.1	5.4	3.0	10.6	13.9	15.0	100
Other	33.2	35.4	0.0	0.9	21.1	4.6	4.8	100
Total Business Taxes	**37.0%**	**22.5%**	**11.7%**	**9.4%**	**8.9%**	**6.6%**	**3.9%**	**100%**

* Includes hospitality industries.

Amounts may appear not to sum due to rounding.

Source: EY Calculations

Appendix: Supplemental Tables

TABLE A-1

Total State and Local Business Taxes, 1980 - 2006 *(Dollars in Billions)*

State and Local Taxes	1980	1985	1990	1995	2000	2001	2002	2003	2004	2005	2006
Total business taxes*	$105.0	$164.2	$230.0	$304.3	$383.2	$396.9	$396.4	$410.0	$449.8	$502.4	$553.7
Individual income taxes	40.3	68.1	98.9	128.1	196.2	209.4	184.8	180.8	193.7	214.9	242.7
Other non-business taxes	78.1	118.0	185.1	244.0	313.8	323.9	329.9	340.9	364.9	397.6	438.1
Total State and Local Taxes	**$223.4**	**$350.3**	**$514.0**	**$676.4**	**$893.2**	**$930.2**	**$911.1**	**$931.7**	**$1,008.4**	**$1,114.9**	**$1,234.5**

Composition of State and Local Taxes	1980	1985	1990	1995	2000	2001	2002	2003	2004	2005	2006
Total business taxes*	47.0%	46.9%	44.8%	45.0%	42.9%	42.7%	43.5%	44.0%	44.6%	45.1%	44.9%
Individual income taxes	18.1	19.4	19.2	18.9	22.0	22.5	20.3	19.4	19.2	19.3	19.7
Other non-business taxes	35.0	33.7	36.0	36.1	35.1	34.8	36.2	36.6	36.2	35.7	35.5
Total State and Local Taxes	**100%**	**100%**	**100%**	**100%**	**100%**	**100%**	**100%**	**100%**	**100%**	**100%**	**100%**

**Includes individual income taxes on pass-through business income.*

Source: EY Calculations

TABLE A-2

Composition of State and Local Business Taxes, 1980 - 2006 *(Dollars in Billions)*

Business Tax	1980	1985	1990	1995	2000	2001	2002	2003	2004	2005	2006
Property taxes on business property	$38.0	$57.6	$85.6	$112.6	$138.1	$144.4	$149.7	$154.2	$167.1	$187.9	$204.8
General sales taxes on business inputs	22.6	37.1	53.5	70.2	94.4	97.6	97.5	100.9	105.4	111.7	124.7
Corporate income tax	13.4	19.3	23.7	31.7	36.4	35.8	29.5	31.7	34.0	42.1	51.8
Unemployment insurance	5.5	9.1	12.4	15.8	20.9	20.8	21.0	23.9	31.9	35.5	36.4
Insurance premiums tax	3.1	4.5	7.4	8.6	9.8	10.3	11.0	12.0	13.3	14.1	14.8
Public utility taxes	5.9	10.0	11.4	15.0	17.8	18.0	18.4	18.1	21.1	25.1	24.5
Excise taxes	4.6	7.2	10.6	16.0	20.2	20.3	20.6	20.3	21.6	24.5	25.7
Business license	1.5	2.5	4.2	6.4	8.4	8.7	11.0	10.9	12.6	13.2	14.4
Corporation license	1.4	2.8	3.1	5.0	6.5	6.4	6.3	6.0	6.4	7.7	8.1
Individual income tax on business income	1.7	2.2	6.6	9.6	15.1	16.3	14.6	14.5	17.2	19.0	21.4
Other business taxes	7.2	11.8	11.5	13.3	15.8	18.5	16.8	17.5	19.3	21.6	27.0
Total Business Taxes	**$104.9**	**$164.1**	**$230.0**	**$304.2**	**$383.4**	**$397.1**	**$396.4**	**$410.0**	**$449.9**	**$502.4**	**$553.6**

Source: EY Calculations

TABLE A-3

Composition of Property Taxes, FY2006 *(Dollars in Billions)*

Business/Non-Business Property Tax	FY2006 Property Tax	% of Total Property Tax
Business property taxes	**$204.8**	**56.4%**
Commercial and industrial property	102.4	28.2
Rental residential property	69.5	19.1
Business personal property	21.2	5.8
Utility property	11.7	3.2
Non-business property taxes	**$158.2**	**43.6%**
Owner-occupied residential	151.3	41.7
Non-business personal property	6.9	1.9
State and Local Property Taxes	**$363.0**	**100.0%**

Source: EY Calculations

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Endnotes

[1] Cline, Neubig, and Phillips, *Total State and Local Business Taxes: Nationally 1980 – 2005, by State 2002 – 2005, and by Industry 2005*, March 2006. Cline, Fox, Neubig, and Phillips, *Total State and Local Business Taxes: Nationally 1980 – 2004 and by State 2000 – 2004*, April 2005. Cline, Fox, Neubig, and Phillips, *Total State and Local Business Taxes: A 50-State Study of the Taxes Paid by Business in FY2003*, January 2004. (Also in *State Tax Notes*, February 26, 2004.) Cline, Fox, Neubig, and Phillips, T*otal State and Local Business Taxes: Fiscal Year 2003 Update*, September 2003. (Also in *State Tax Notes*, October 14, 2003.) Cline, Fox, Neubig, and Phillips, *A Closer Examination of the Total State and Local Business Tax Burden*, January 2003. (Also in *State Tax Notes*, January 17, 2003.)

[2] The methodology used to estimate state and local business taxes is described in detail in the Appendix to the March 2006 report cited in Endnote 1.

[3] A more detailed analysis of state and local sales taxation of business inputs was done by Robert Cline, John Mikesell, Tom Neubig, and Andrew Phillips in the COST study, *Sales Taxation of Business Inputs: Existing Tax Distortions and the Consequences of Extending the Sales Tax to Business Services*, January 25, 2005. (Also in *State Tax Notes*, January 28, 2005.)

[4] Some of the historical numbers reported have been revised from the earlier business tax studies as a result of the use of more detailed information on business taxes by state and feedback from state tax agencies.

[5] This study follows the classification of business taxes (as gross receipts, corporate income, franchise, or license taxes) establish the Census Bureau.

[6] See Cline, Robert; Kim, Joomi; and Phillips, Andrew, *Property Taxes on Business Capital: Large and Growing Share of State and Local Business Taxes*, presented at the National Tax Association Annual Conference, November 2005.

[7] In Figure 4 and Table 3, the excise and gross receipts taxes category includes excise, insurance premiums, and public utility taxes. The business license and other taxes category includes corporate license, business license, and other business taxes.

[8] For a discussion of mobile capital investments and interstate investment trends, see *The 2006 U.S. Investment Monitor*, Ernst & Young LLP, August 7, 2006.

Conclusions

It is important for policymakers to understand the level and composition of their state's total state and local business taxes.

State and local taxes paid by businesses in FY2006 totaled $554 billion, increasing more than 10% since FY2005 and nearly 40% from FY2002, the trough of the last recession. Total business taxes represent 44.9% of all state and local taxes collected in FY2006, up from 43.5% in FY2002.

The study's findings show that the increase in business taxes since FY2002 has accounted for nearly half of the increase in total state and local taxes. Annual increases in property taxes and sales tax on business inputs, the two largest state and local business taxes, accounted for most of the increase, but corporate income and employment taxes have shown typically strong, post-recession growth rates.

Relative to overall economic activity, state and local business taxes increased from 4.5% to 5.1% of private-sector GSP over the same period. In other words, the effective business tax rate increased from FY2002 to FY2006 because business taxes are increasing faster than overall private-sector growth.

The composition of total state and local business taxes paid can vary dramatically by industry. As indicated by this study, legacy taxes on traditionally regulated businesses can represent nearly half of the entire state and local tax burden paid by companies in these industries. Other industries, including manufacturing and transportation, continue to face significant property and sales tax liabilities.

In an economic environment affected significantly by increased global competition, continued deregulation, the growing importance of intangible assets, and increased mobile labor and capital, it is important for policymakers to understand the level and composition of their state's total state and local business taxes.[8]

Business Taxes by Industry

The results of this study highlight the importance of evaluating the overall level of state and local business taxes in the tax policy debate. Table 7 adds another dimension to the total business tax results, presenting estimates of total state and local taxes paid by major industries in FY2006. The results indicate that the composition of total state and local business taxes varies significantly among industries.

TABLE 7

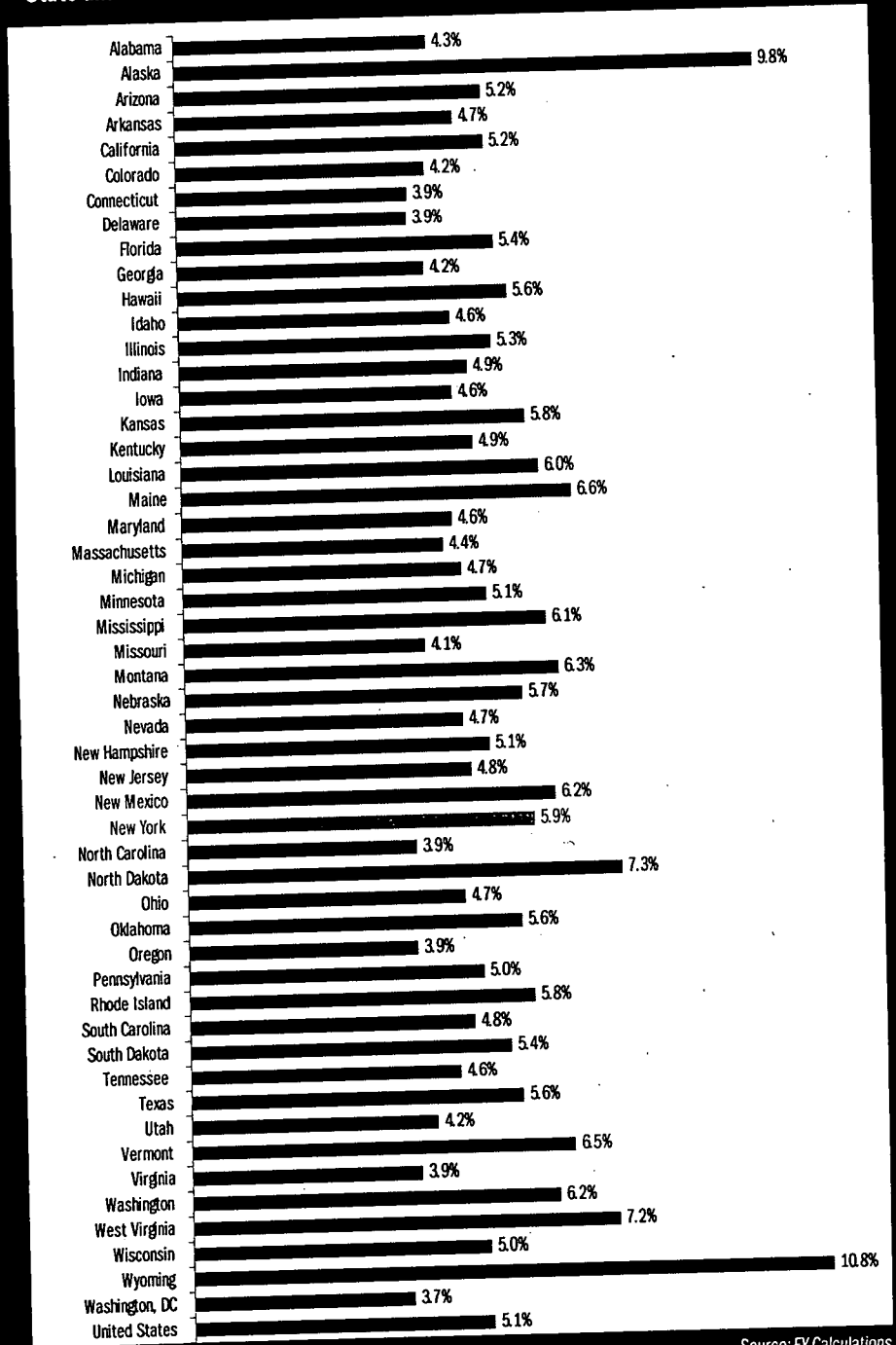
State and Local Business Taxes by Industry, FY2006* *(Dollars in Billions)*

Industry	Property Taxes	Sales Tax on Business Inputs	Excise and Gross Receipts	Corporate Income Tax	Business License and Other Taxes	Payroll Taxes	Individual Income Tax (on Pass-Through Business Income)	Total Business Taxes
Electric & gas	$18.6	$3.3	$17.2	$1.0	$1.5	$0.3	0.0*	$41.8
Manufacturing	29.5	21.6	0.2	16.2	4.9	9.5	0.3	82.2
Non-Durable	14.1	9.5	0.2	6.0	2.6	3.1	0.1	35.6
Durable	15.4	12.1	0.0*	10.2	2.2	6.4	0.2	46.6
Wholesale trade	9.2	10.8	15.5	3.3	3.0	2.0	0.4	44.2
Retail trade**	11.9	17.2	5.4	6.0	3.2	6.3	1.1	51.1
Transportation	9.2	6.8	1.2	0.6	1.3	1.3	0.8	21.3
Communications	5.9	5.7	6.3	2.2	1.2	0.5	0.2	22.0
Finance and Insurance	15.9	12.0	14.8	9.6	4.9	1.7	1.4	60.4
Real Estate	63.2	1.4	0.0*	0.8	1.6	0.5	1.7	69.3
Management of Companies	0.7	0.5	0.0*	9.0	5.9	0.1	0.3	16.5
Services	19.5	22.9	4.4	2.5	8.6	11.3	12.2	81.4
Other	21.1	22.5	0.0*	0.6	13.4	2.9	3.0	63.6
Total Business Taxes	**$204.8**	**$124.8**	**$65.1**	**$51.8**	**$49.4**	**$36.4**	**$21.4**	**$553.7**

*Note: $0.0 indicates a value less than $50 million. ** Includes hospitality industries. *Amounts may appear not to sum due to rounding.* *Source: EY Calculations*

FIGURE 4

State and Local Business Taxes as a Percent of Private-Sector Economic Activity, FY 2006



Source: EY Calculations

Figure 4 illustrates the variation in business ETRs (total state and local business taxes as a percentage of private-sector economic activity) for each of the 50 states and the District of Columbia. The share of state business taxes and local business taxes is shown separately.

On the following page, Table 6 shows the state-by-state increase in total state and local business taxes between FY2002 and FY2006 and the business share of total state and local tax increases during that period. For all states, businesses paid almost 49% of the increase in all state and local taxes over this four-year period. Although not shown in the table, the picture is the same for the aggregate ETR: The ra[illegible] business taxes to private-sector economic activity increased from 4.5% to 5.1% over the same period.

TABLE 4

State and Local Business Taxes by Type, FY2006* *(Dollars in Billions)*

State	Property Tax	Sales Tax on Business Inputs	Excise and Gross Receipts	Corporate Income	Unemployment Insurance	Individual Income Tax (on Pass-Through Business Income)	Licenses and Other Taxes	Total Business Taxes
Alabama	$1.3	$1.2	$1.3	$0.5	$0.3	$0.2	$0.6	$5.4
Alaska	0.9	-	0.1	0.8	0.2	-	1.2	3.2
Arizona	3.8	3.4	0.9	0.9	0.3	0.2	0.3	9.8
Arkansas	0.9	1.1	0.5	0.4	0.3	0.2	0.2	3.6
California	19.7	20.5	7.8	10.4	5.4	4.9	6.5	75.2
Colorado	3.1	2.4	0.6	0.5	0.5	0.5	0.4	8.0
Connecticut	2.7	1.5	0.7	0.6	0.6	0.5	0.2	6.8
Delaware	0.3	-	0.2	0.3	0.1	0.1	1.1	2.1
Florida	11.6	7.7	7.6	2.4	1.2	-	1.5	32.0
Georgia	5.1	4.1	1.2	1.0	0.7	0.7	0.5	13.3
Hawaii	0.6	0.8	0.5	0.1	0.1	0.1	0.1	2.3
Idaho	0.8	0.3	0.2	0.2	0.1	0.1	0.1	1.8
Illinois	11.2	3.8	4.4	2.4	2.7	0.6	1.6	26.7
Indiana	6.0	1.7	0.6	1.0	0.6	0.3	0.2	10.4
Iowa	2.6	0.7	0.3	0.2	0.3	0.2	0.3	4.6
Kansas	2.4	1.2	0.5	0.4	0.3	0.2	0.3	5.3
Kentucky	1.5	1.3	0.8	1.0	0.4	0.3	0.7	6.0
Louisiana	2.2	4.2	0.8	0.3	0.2	0.1	1.1	8.9
Maine	1.4	0.4	0.2	0.2	0.1	0.1	0.1	2.5
Maryland	3.5	1.4	1.4	0.8	0.5	0.5	1.2	9.3
Massachusetts	5.9	1.6	0.9	1.8	1.7	0.8	0.4	13.1
Michigan	7.1	2.6	1.1	1.9	1.6	0.6	0.9	15.8
Minnesota	4.5	1.9	1.3	1.1	0.9	0.4	0.6	10.7
Mississippi	1.7	1.1	0.4	0.4	0.1	0.1	0.3	4.1
Missouri	2.6	2.2	1.0	0.3	0.6	0.3	0.7	7.7
Montana	0.7	-	0.2	0.2	0.1	0.1	0.4	1.6
Nebraska	1.5	0.9	0.3	0.3	0.2	0.1	0.2	3.5
Nevada	1.5	1.4	0.7	-	0.3	-	0.8	4.7
New Hampshire	1.4	-	0.3	0.6	0.1	0.0	0.1	2.5
New Jersey	7.5	2.7	2.0	2.9	1.6	0.8	1.2	18.7
New Mexico	0.6	1.1	0.3	0.3	0.1	0.1	1.0	3.5
New York	20.0	11.3	4.1	7.1	2.6	3.4	2.0	50.5
North Carolina	3.7	2.5	1.7	1.3	1.0	0.6	0.8	11.6
North Dakota	0.5	0.2	0.2	0.1	0.1	0.0	0.4	1.5
Ohio	7.5	4.0	1.5	1.6	1.1	0.8	1.8	18.3
Oklahoma	1.2	1.7	0.5	0.3	0.3	0.4	1.4	5.8
Oregon	2.0	-	0.4	0.4	0.7	0.4	0.8	4.7
Pennsylvania	7.2	3.4	2.8	2.1	2.5	0.9	3.2	22.1
Rhode Island	1.0	0.4	0.3	0.3	0.2	0.1	0.1	2.4
South Carolina	2.8	1.1	0.6	0.3	0.3	0.2	0.4	5.7
South Dakota	0.7	0.5	0.1	0.1	0.0	-	0.1	1.5
Tennessee	3.1	2.8	0.9	0.9	0.4	0.0	1.2	9.3
Texas	22.2	11.9	6.3	-	1.7	-	7.3	49.4
Utah	1.0	0.8	0.4	0.3	0.2	0.2	0.2	3.1
Vermont	0.8	0.1	0.2	0.1	0.1	0.0	0.0	1.3
Virginia	4.3	1.5	2.1	0.9	0.5	0.5	1.5	11.3
Washington	3.4	6.6	2.0	-	1.5	-	0.7	14.2
West Virginia	1.0	0.3	0.6	0.5	0.1	0.1	0.5	3.1
Wisconsin	4.3	1.8	0.8	1.0	0.7	0.3	0.6	9.5
Wyoming	0.8	0.4	0.1	-	0.0	-	1.3	2.6
Dist. of Columbia	0.8	0.3	0.2	0.2	0.1	0.1	0.2	1.9
United States	**$204.9**	**$124.8**	**$64.9**	**$51.7**	**$36.3**	**$21.1**	**$49.3**	**$553.7**

**Note: $0.0 indicates a value less than $50 million.*

Amounts may appear not to sum due to rounding.

Source: EY Calculations

(Dollars in Billions)

TABLE 3-A

State and Local Business Taxes, FY2006	FY2006	% Total Taxes	One-Year Growth
Property taxes on business property	$204.8	37.0%	9.0%
Sales and use tax on business inputs	124.7	22.5	11.6
Corporate income tax	51.8	9.4	23.1
Unemployment insurance	36.4	6.6	2.5
Excise taxes	25.7	4.6	4.7
Public utility taxes	24.5	4.4	-2.2
Business and corporate license	22.4	4.0	7.4
Individual income tax on business income	21.4	3.9	13.1
Insurance premiums tax	14.8	2.7	5.3
Other business taxes	27.0	4.9	25.2
Total Business Taxes	**$553.7**	**100.0%**	**10.2%**

TABLE 3-B

State Business Taxes, FY2006	FY2006	% Total Taxes	One-Year Growth
Sales and use tax on business inputs	$98.5	32.8%	12.4%
Corporate income tax	48.5	16.2	23.2
Unemployment insurance	36.4	12.1	2.5
Business and corporate license	22.4	7.5	7.4
Individual income tax on business income	21.4	7.1	13.1
Excise taxes	20.0	6.7	3.7
Insurance premiums tax	14.8	4.9	5.3
Public utility taxes	12.6	4.2	-5.7
Property taxes on business property	8.1	2.7	-9.8
Other business taxes	17.3	5.8	17.6
Total Business Taxes	**$300.0**	**100.0%**	**10.0%**

TABLE 3-C

Local Business Taxes, FY2006	FY2006	% Total Taxes	One-Year Growth
Property taxes on business property	$196.7	77.6%	9.9%
Sales and use tax on business inputs	26.2	10.3	8.8
Public utility taxes	11.9	4.7	1.7
Excise taxes	5.7	2.2	8.4
Other business taxes*	13.1	5.2	35.6
Total Business Taxes	**$253.6**	**100.0%**	**10.4%**

*Includes local corporate income and business license taxes that are included in state and local tax totals.

Source: EY Calculations

TABLE 2

Change in State and Local Business Taxes, FY2002 to FY2006 *(Dollars in Billions)*

Business Tax	FY2002	FY2006	% Growth in Tax FY2002 - FY2006	% of Total Tax Increase
Property taxes on business property	$149.7	$204.8	36.8%	35.0%
Sales and use tax on business inputs	97.5	124.7	27.9	17.3
Corporate income tax	29.5	51.8	75.6	14.2
Unemployment insurance	21.0	36.4	73.3	9.8
Excise taxes	20.6	25.7	24.8	3.3
Public utility taxes	18.4	24.5	33.2	3.9
Business and corporate license	17.3	22.4	29.5	3.3
Individual income tax on business income	14.6	21.4	46.6	4.4
Insurance premiums tax	11.0	14.8	34.5	2.4
Other business taxes	16.8	27.0	60.7	6.5
Total Business Taxes	**$396.4**	**$553.7**	**39.7%**	**100.0%**
Total State and Local Taxes	**$911.1**	**$1,234.5**	**35.5%**	

Source: EY Calculations

While the corporate income tax continues to represent a relatively small share of total state and local business taxes, it remains an unstable source of revenue for funding government. The relative volatility in the corporate income tax has been particularly high since the beginning of the last recession. From June 2001 to June 2002, corporate income taxes fell almost five times faster than total state taxes. Since June 2002, corporate income taxes have increased almost three times faster than all state taxes. The short-run volatility of corporate income taxes makes it difficult to identify longer-run trends affecting the tax.

Over the past decade, many states have considered significant changes in their business tax systems. Two states, Ohio and Texas, replaced income and franchise tax systems with modified gross receipts taxes. Michigan repealed its single business tax (after 2007), classified by the Census Bureau as a corporate income tax, and has not yet adopted a replacement. Hawaii and Washington have existing business gross receipts taxes that are classified as sales taxes in our analysis. The substitution of these new taxes for current business income and franchise taxes will affect the composition of business taxes going forward.[5]

Local Business Taxes Are Growing Faster Than State Business Taxes

Local business taxes grew faster than state-level business taxes from FY2005 to FY2006. Local business taxes increased 10.4%, while state business taxes grew by 10.0%.

The relatively high business property tax growth rate, combined with the importance of the property tax in the local tax mix, primarily responsible for the higher local growth rate.[6] (See Appendix Table A-3 for details of the composition of business property taxes.)

Figure 3 illustrates the significant difference in the composition of state and local business taxes. The first pie shows the percentage distribution of total state and local taxes by tax type. The property tax share for total taxes is 37%. But the second and third pies show that the business property tax accounts for 3% of state taxes but 78% of local taxes.[7]

Table 3 provides the dollar amounts, percentage distribution, and growth rates in FY2006 for total state and local taxes, as well as state taxes and local taxes reported separately. As shown in Table 3-C, total local taxes increased by 10.4% primarily due to property tax growth of 9.9%. Other local taxes, including local business income and license taxes, grew 35.6%. Table 3-B shows that while local property taxes grew significantly, state-level property taxes decreased 9.8%. The decrease was largely due to legislated state property tax reductions, including a two-cent state property tax rate reduction in Maryland and the repeal of the Florida state intangible property tax.

Total State and Local Business Taxes in FY2006

Businesses paid $554 billion in total state and local taxes in FY2006, as presented in Table 1.[2] The following taxes are included in the business tax estimates to the extent each tax is determined to be the statutory liability of businesses and their owners:

- Property taxes on real, personal, and utility property owned by business account for the largest share of total state and local business taxes: 37% or nearly $205 billion. Taxes on real property and utilities account for $184 billion (90%) of the total business property tax. Business personal property, which is exempt from tax in many states, generates the remaining $21 billion of business property tax revenue.

TABLE 1

State and Business Taxes, FY2006 *(Dollars in Billions)*

Business Tax	Business Taxes	% of Total	One-Year Growth
Property taxes on business property	$204.8	37.0%	9.0%
Sales and use tax on business inputs	124.7	22.5	11.6
Corporate income tax	51.8	9.4	23.1
Unemployment insurance	36.4	6.6	2.5
Excise taxes	25.7	4.6	4.7
Public utility taxes	24.5	4.4	-2.2
Business and corporate license	22.4	4.0	7.4
Individual income tax on business income	21.4	3.9	13.1
Insurance premiums tax	14.8	2.7	5.3
Other business taxes	27.0	4.9	25.2
Total State and Local Taxes	**$553.7**	**100.0%**	**10.2%**

Source: EY Calculations

- Sales and use taxes paid by businesses on purchases of inputs, including capital equipment, totaled $125 billion, representing 23% of all state and local business taxes and 44% of total state and local sales and use taxes. Sales and use taxes collected on sales to final consumers are not included; only the taxes paid on businesses' operating inputs and capital equipment purchases are included in the total business tax estimates.[3]
- Corporate income taxes were $52 billion and equaled 9% of total state and local business taxes.
- Excise taxes imposed on business purchases accounted for more than $26 billion of FY2006 revenue. Although businesses generally collect and remit excise taxes on all taxable sales, the estimates only include taxes paid on purchases by businesses. Excise taxes attributed to business include a portion of motor fuel taxes and other selected excise taxes, such as hotels and rental car taxes. Taxes on tobacco, alcoholic beverages, amusements, and pari-mutuels are allocated to households.
- Taxes on insurance premiums and public utility gross receipts totaled $39 billion in FY2006. These taxes are generally based on business gross receipts, and because they are often levied in lieu of property or corporate income taxes, they are allocated solely to business.
- Employer payroll taxes for unemployment insurance were more than $36 billion in FY2006.
- License taxes and other business totaled $49 billion in FY2006. Of this total, nearly $8 billion was corporation license taxes, such as the Texas franchise tax ($2.7 billion); $14 billion was general business and occupation taxes; $18 billion was motor vehicle license fees and taxes.
- Individual income taxes paid by owners of pass-through entities (e.g., partnerships, sole proprietorships, S-corporations, etc.) are estimated to total $21 billion in FY2006. Individual income taxes on pass-through business income were 41% as large as state corporate income taxes and represent 4% of total state and local business taxes.

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This study was prepared by the Quantitative Economics and Statistics practice (QUEST) of Ernst & Young LLP in conjunction with the Council On State Taxation (COST).

QUEST is a group of economists, statisticians, and tax policy researchers within Ernst & Young's National Tax practice, located in Washington, DC. QUEST provides quantitative advisory services to private- and public-sector clients that enhance business processes, support regulatory compliance, analyze proposed policy issues, and provide litigation support.

COST is a nonprofit trade association based in Washington, DC. COST was formed in 1969 as an advisory committee to the Council of State Chambers of Commerce and today has an independent membership of nearly 600 major corporations engaged in interstate and international business. COST's objective is to preserve and promote the equitable and nondiscriminatory state and local taxation of multi-jurisdictional business entities.

Recommendations of the State and Local Fiscal Modernization Study Commission to the General Assembly:

The following recommendations have been identified as high priority items by the State and Local Fiscal Modernization Study Commission. In summary, the recommendations:

- make the sales tax more progressive by broadening the sales tax base to include many services that are currently exempt from the sales tax (warranty and repair services, entertainment services, etc.) and by broadening the sales tax base to include currently exempt food items;

- broaden the individual income tax base, take low-income taxpayers off the tax rolls and reduce income tax rates across all income levels;

- reduce the top corporate tax rate and adopt combined reporting;

- provide relief to local government through the State's assumption of a portion of Medicaid costs;

- provide greater flexibility to city and county governments with respect to how they raise revenue by allowing a menu of options including real estate transfer fees or deed stamp taxes, impact fees, motor vehicle license fees and other vehicle use fees, taxes on prepared food and drink, and occupancy taxes;

- provide funding for water and sewer infrastructure;

- eliminate differential sales tax rates; and

- modernize the local ad valorem tax on real property and provide local governments flexibility in providing tax relief for elderly and fixed income residents.

The Commission believes that these recommendations should be approved by the General Assembly and signed into law by the Governor during this legislative session. As the General Assembly considers options to modernize the state and local system of taxation, the Commission respectfully urges its members <u>not</u> to make changes unless they are consistent with these recommendations. Members of the General Assembly should also be aware that the Commission has made other recommendations which while not as high a priority are nonetheless important and should be considered by the legislature in the future.

Each of the recommendations can stand alone with the exception of the first and second recommendations. Significant income tax rate reductions can only be accomplished in a revenue-neutral manner by offsetting the revenue loss with additional revenue from broadening the sales tax base.

Detailed revenue estimates of each recommendation are not available at this time. Accordingly, it may be necessary to adjust tax rates in order for the recommendations to be revenue neutral. In addition, a detailed incidence analysis of the recommendations is not available at this time. To the extent that low-income taxpayers are adversely affected by the recommendations, the proposed standard deduction and or exemption amounts should be modified.

Specific Recommendations:

1. Broaden the sales tax base and lower the sales tax rate.

(A). Effective January 1, 2008, the following services which are commonly taxed by other states should be included in the sales tax base and taxed at the combined general rate:

- pet grooming services;
- landscaping;
- typesetting;
- storage (automotive, fur, household goods, marina services, and so on);
- carpet and upholstery cleaning;
- garment repair and altering;
- gift and package wrapping;
- services provided by health clubs and tanning parlors;
- shoe repair;
- swimming pool cleaning and maintenance;
- janitorial services;
- exterminating services;
- telephone answering services;
- tire recapping and repairing;
- window cleaning;
- automotive services;
- entertainment services (some of which are currently taxed at 3%);
- warranty services; and
- currently exempt installation and repair services.

The Commission recommends that the sales tax should be expanded to include a broad range of additional services but has identified significant issues which must be addressed before final recommendations can be made.

(B). Effective January 1, 2008, currently exempt food items should be taxed at the combined general rate. The Commission recommends that low-income taxpayers receive targeted income tax relief to offset the additional sales tax burden caused by taxing food at the combined general sales tax rate.

Increases in sales tax revenue from the base broadening described above should be used to offset revenue losses from changes in the income tax. To the extent that additional sales tax revenue exceeds reductions in income tax revenue, both state and local sales tax rates should be lowered in a revenue neutral fashion.

2. Reduce the top marginal individual income tax rate, broaden the individual income tax base and reduce the number of individual income tax filers.

(A). Effective January 1, 2008, the base for calculating North Carolina taxable income should be federal adjusted gross income (AGI) with minimal exclusions and deductions as required by law (retirement income exempted from North Carolina income tax under the *Bailey* decision, interest on federal obligations, interest on in-state municipal bonds) or equity considerations (North Carolina income tax refunds included in federal AGI and a deduction for higher education tuition payments when a credit is claimed on the federal return).

(B). Effective January 1, 2008, individual income tax rates should be reduced as shown in the following table:

Marginal Rate on Taxable Income*	Single/MFS	MFJ/QW	HOH
3 – 4%	Up to $10,000	Up to $20,000	Up to $15,000
4 – 5%	$10,001 - $60,000	$20,001 - $120,000	$15,001 - $90,000
5 – 6%	$60,001 - $120,000	$120,001 - $240,000	$90,001 - $180,000
6 – 7%	$120,001 +	$240,000 +	$180,000+

* The proposed rates assume that additional revenues from broadening the sales tax will be used to offset revenue losses resulting from reductions in individual income tax rates. To the extent that increased revenues from the sales tax are used to reduce sales tax rates and not income tax rates, the rate reductions proposed above will not be possible.

(C). Effective January 1, 2008, a standard deduction from federal AGI should be allowed. For low income taxpayers, this standard deduction is intended to remove significant numbers of taxpayers from tax filing and payment obligations and to offset the impact of increasing sales taxes. A smaller standard deduction should be allowed for taxpayers with moderate and higher amounts of income.

The standard deduction should range from $0 to $16,000 as shown in the following table:

Standard Deduction**	Single/MFS	MFJ/QW	HOH
$8,000/$16,000/$12,000	$0 - $60,000	$0 - $120,000	$0 - $90,000
$4,000/$8,000/$6,000	$60,001 - $120,000	$120,001 - $240,000	$90,001 - $180,000
None	$120,001 +	$240,000 +	$180,000+

* These amounts should be modified as necessary in order to ensure that low income taxpayers are not adversely impacted by the recommended changes.

(D). Effective January 1, 2008, deductions from federal AGI should be allowed for personal and dependency exemptions. The allowable exemption amount should vary depending on filing status and North Carolina taxable income as shown below:

Exemption Amount	Single/MFS	MFJ/QW	HOH
$2,000	$0 - $60,000	$0 - $120,000	$0 - $90,000
$1,200	$60,001 - $120,000	$120,001 -$240,000	$90,001 - $180,000
None	$120,001 +	$240,000 +	$180,000+

Comparison of Tax Payment Thresholds Under Current Law with Recommended Changes

Under current law, the first $5,500 of income of a single taxpayer with no dependents would be exempt from North Carolina income tax. Under the Commission's recommendations, this taxpayer could earn up to $10,000 without owing any North Carolina income tax.

Under current law, a taxpayer that files as head of household with two dependents would pay no income tax on $15,224 of income (after taking into account the current child credit of $100 per child). Under the Commission's recommendations, this taxpayer could earn up to $18,000 without owing any North Carolina income tax (before any allowable child tax credit).

Under current law, $11,000 of income of a married couple with no children would be exempt from North Carolina income tax. Under the Commission's recommendations, this taxpayer could earn up to $20,000 without owing any North Carolina income tax.

Under current law, a married couple with two children would pay no income tax on the first $19,334 of income (after taking into account the current child credit of $100 per child). Under the Commission's recommendations, this family could earn up to $24,000 without owing any North Carolina income tax (before any allowable child tax credit).

(E). Under current law, a variety of income tax credits are allowed including credits for child and dependent care expenses, credits for children, credits for charitable contributions for non-itemizers, credits for qualified business investments, business incentives and energy tax credits, credits for disabled taxpayers, dependents and spouses, credits for real property land donations, credits for rehabilitating historic structures and mill facilities, credits for property taxes on farm machinery, credits for handicapped dwelling units, credits for conservation tillage equipment, credits for gleaned crops, credits for poultry composting, and credit for recycling oyster shells.

The Commission recommends that the Revenue Laws Study Committee should review the current individual income tax credits to determine the extent to which the current credits should be continued, recommend any phase-outs of the current credits and determine the extent to which the tax rates above would need to be adjusted in order to maintain revenue neutrality if any or all credits are retained. The Revenue Laws Study Committee should also consider whether an education deduction should be allowed for higher education tuition payments when an education credit is taken instead of a deduction for federal tax purposes.

3. Reduce the corporate income tax rate and require combined reporting.

Effective January 1, 2009, affiliated groups of corporations that are engaged in a unitary business should be required to file combined returns. An affiliated group is defined as a group of two or more corporations in which more than 50% of the voting stock of each member corporation is directly or indirectly owned by a common owner or owners, either corporate or non-corporate, or by one or more of the member corporations. A unitary business is defined as one or more related business organizations engaged in business activity both within and without the State among which one or more of the following exist: a unity of ownership, operation or use or an interdependence in their functions. A unitary business should be defined as broadly as allowed under current judicial authority.

Members of a combined group should be allowed to make a "water's edge" election and thereby elect to disregard the income and apportionment factors of a member of the combined group that is a foreign corporation that conducts eighty percent or more of its business activity outside the United States and outside a tax haven country.

The corporate tax rate should be reduced in a revenue neutral fashion. Based on conservative assumptions of the impact of combined reporting, the corporate rate should be reduced to 6% or lower.

4. The State should assume responsibility for the nonfederal share of Medicaid Assistance Program costs, excluding administrative costs.

Alternatives include:

(A). An immediate takeover at a cost to the State of approximately $500 to $600 million, or

(B). A takeover accomplished over 3 to 4 years. Alternatives include:

(1). assuming responsibility for a portion of Medicaid in excess of a percentage of property values in each county. Complete Medicaid relief would be phased-in over 3 to 4 years by reducing the threshold required for relief. For example, the State could immediately assume responsibility for Medicaid expenditures in excess of the revenue received by a $.10 tax on real property within each county. The one-year cost to the state would be approximately $51 million. Phasing in the takeover in this manner would provide immediate relief for about one-third of the counties in the State.

(2). cutting the county share of Medicaid across the board in order to provide relief to all counties.

The shift in responsibility from the counties to the State should be accompanied by a shift in funding sources or by the State identifying new sources of revenue. A shift in funding sources could be accomplished through the counties giving up the 2% local sales tax on food or other sources of revenue currently shared among the State and the counties such as the 2.5% local sales tax, lottery proceeds, corporate income tax, etc.

5. The State should provide greater flexibility to city and county governments with respect to how they raise revenue by providing a menu of options including real estate transfer fees or deed stamp taxes, impact fees, motor vehicle license fees and other vehicle use fees, taxes on prepared food and drink, and occupancy taxes.

   Each city and county government should have the same authority and the ability to pick and choose which revenue sources are appropriate.

   The Revenue Laws Study Committee should study and set maximum rates for each tax.

6. Provide funding for water and sewer infrastructure.

The State of North Carolina should issue bonds, the proceeds of which should be used to provide funding for water and sewer infrastructure. Funds should be allocated to local utilities with the greatest need and should be used to provide incentives to regionalize or otherwise provide more cost effective services.

7. Eliminate differential rates in the sales tax.

The following transactions that are currently subject to sales or excise tax at special rates should be taxed at the combined general sales tax rate.

(A). All sales of motor vehicles taxed under the highway use tax. The tax is to be assessed on the retail value of the motor vehicle with no reduction for an allowance given by the seller for trade-ins. Taxes collected on motor vehicles at the combined general tax rate should be credited to the North Carolina Highway Trust Fund.

(B). Admissions and amusements currently taxed at 3%.

(C). Long-term leases and rentals of motor vehicles.

8. Modernize the local ad valorem tax on real property and provide local governments flexibility in providing tax relief for elderly and fixed income residents.

(A). Effective January 1, 2008, local governments should be given the option to provide property tax deferrals for elderly and fixed income residents. Requirements for deferral and events that result in the payment of deferred tax should be uniform across the state and determined by the Property Tax Subcommittee of the Revenue Laws Study Committee.

(B). Effective January 1, 2008, the State should require each county of the State to:

(1). reappraise all real property in any year following a year in which the median sales assessment ratio (as conducted by the Department of Revenue) does not exceed .90, or

(2). revalue property on an annual basis using annual indexing with an index to be determined for each county by the Department of Revenue.