

To: Main Management
From: Dick Fredericks
Re: North Carolina's Tax Success Could be a Template for a National Tax Bill
September 21, 2017

In today's Wall Street Journal, there was an editorial by Tom Tillis, the junior US Senator from North Carolina about the how tax reform transformed his state. (see [here](#)). What he described was a successful effort to revamp the North Carolina tax system to promote faster growth in the state. Critics said the tax cut would cripple state. Instead ... it has been very successful and could be a good template for consideration for the nation's forthcoming tax package. At a minimum, it is evidence that collected taxes can increase despite the introduction of significant tax cuts. Specifically, Senator Tillis and the North Carolina legislature proposed three principles to follow – 1) simplify the tax code, 2) lower rates, and 3) broaden the tax base.

The motivation for the tax package was that North Carolina had one of the highest business tax rates in the country, ranking of 44th worst according to the Tax Foundation. When the Republicans took control of the North Carolina legislature in 2010, the state had the highest personal and corporate tax rates in the Southeast with personal and corporate tax rates of 7.5% and 6.9%, respectively. With a series of tax reductions beginning with the 2013 tax reform act, the personal rate is now 30% lower and the corporate rate is 69% lower in just four years. The Tax Foundation (See [here](#)) described the impact in a September 2016 report by stating ...

“After the most dramatic improvement in the *Index's* history—from 41st to 11th in one year—North Carolina has continued to improve its tax structure, and now imposes the lowest-rate corporate income tax in the country at 4 percent, down from 5 percent the previous year. This rate cut improves the state from 6th to 4th on the corporate income tax component, the second-best ranking (after Utah) for any state that imposes a major corporate tax. (Six states forego corporate income taxes, but four of them impose economically distortive gross receipts taxes in their stead.)

An individual income tax reduction, from 5.75 to 5.499 percent, is scheduled for 2017. At 11th overall, North Carolina trails only Indiana and Utah among states which do not forego any of the major tax types”.

What the legislature actually passed follows:

- **A flat tax personal of 5.499% (which drops to 5.25% in January 2019)**
- **Lowered the corporate tax to 3% in 2017. It was 7.5% in 2012; 6.9% in 2013; 6% in 2014; 5% in 2015; 3% this year, and it is headed to 2.5% in 2019**
- **Increased the standard deduction**
- **Repealed the death tax**

The tax cuts were ‘paid for’ by ...

- **Expanding the tax base**
- **Closing loopholes**
- **Slowing spending, and,**
- **Reducing the cost of entitlement costs, and eliminated “refundable” earned-income tax credits for people who pay no taxes**

Did it work? Yes, according to Senator Tillis in the Wall Street Journal article. He cites the facts that the state has moved to one of the most competitive tax codes of any state in the country; 350,000 jobs have been created since the tax bill has passed; the unemployment rate has been cut nearly in half; the state’s economy has jumped from one of the slowest growing states in the country to one of the fastest; and North Carolina is now considered to be one of the best states in which to run a business.

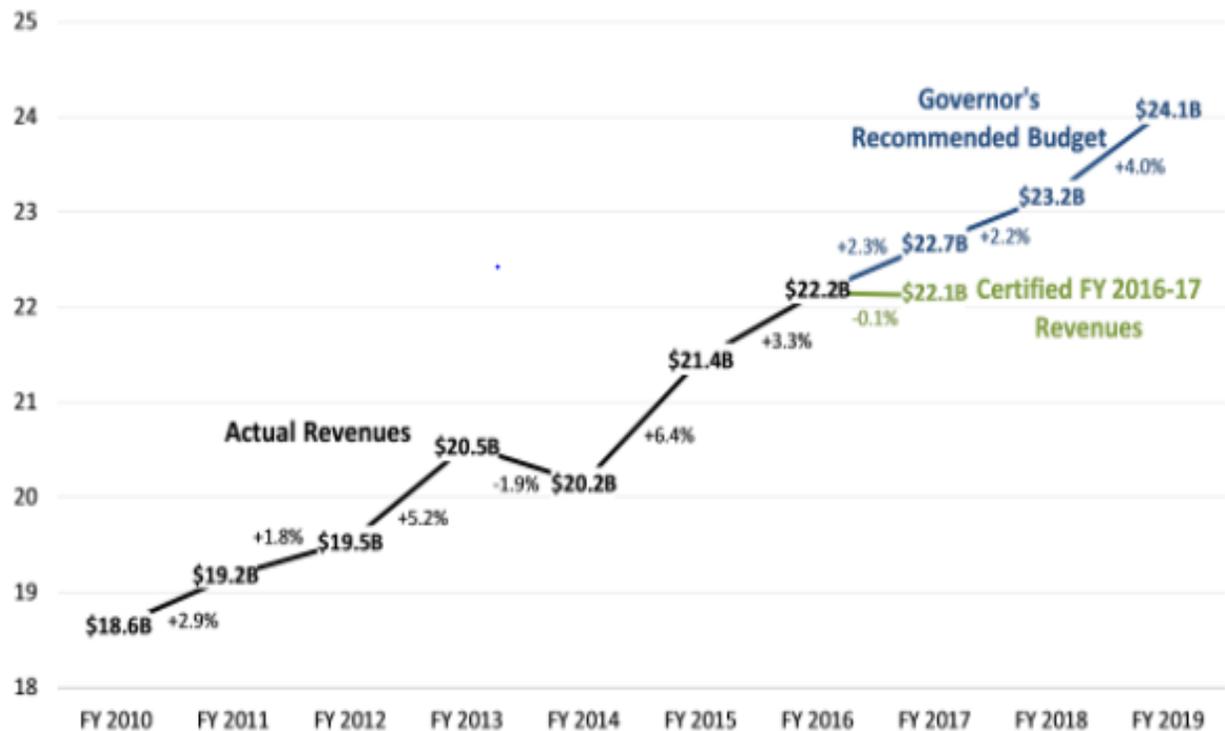
Importantly, despite the fears of many that the tax cuts would lead to dramatically lower revenues that would necessitate massive budget cuts later, the opposite is true. The state has enjoyed expanding revenues every year since the tax program was passed and “\$400 million in budget surpluses are the new norm”. Those surpluses are now being channeled into better pay for teachers and for education spending overall and are

also available for further tax cuts in the future. The overall message: “more growth, more jobs, more businesses and more revenue”.

A visual of the success was posted on the North Carolina website (see [here](#)) and can be seen below. [Note: while the WSJ article cited revenue increase each year, the chart below shows a dip in 2014. We suspect the difference stemmed from people and corporations maneuvering to take advantage of better tax rates that were pending the following year]

General Fund Revenue: Recent History & Forecast

Billions of Current-Year Dollars



Source: OSBM data and projections