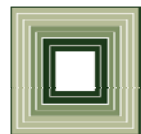


General Fund Revenue Sources

Economy & Finance Team
NCGA Fiscal Research Division
2006-07

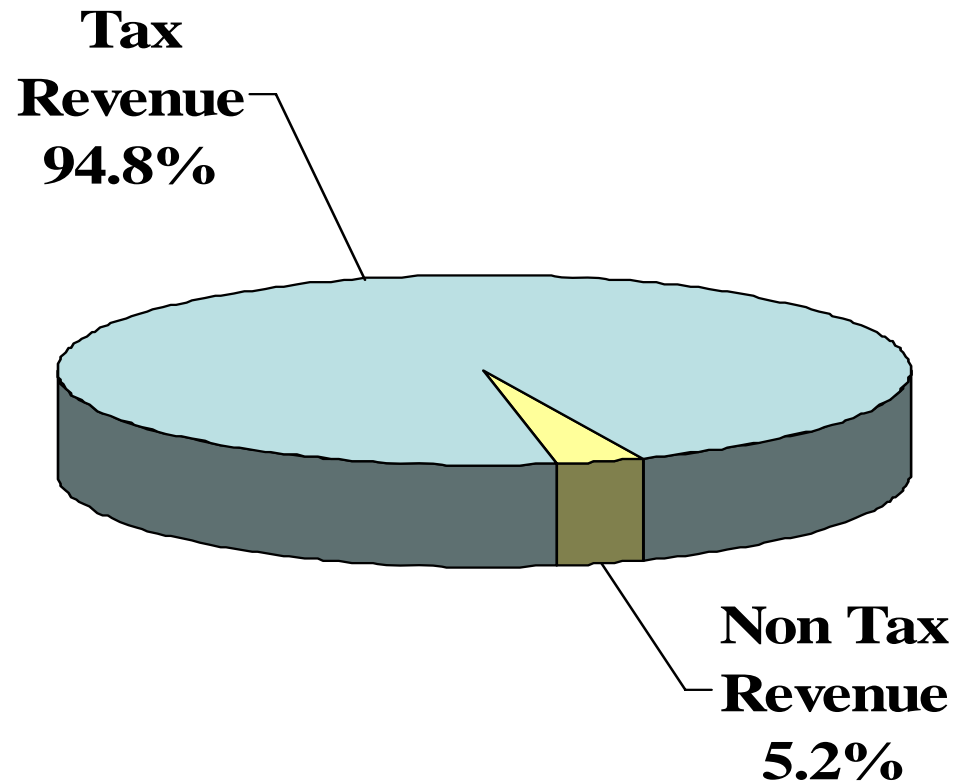


FISCAL RESEARCH DIVISION
A Staff Agency of the North Carolina General Assembly

General Fund Overview

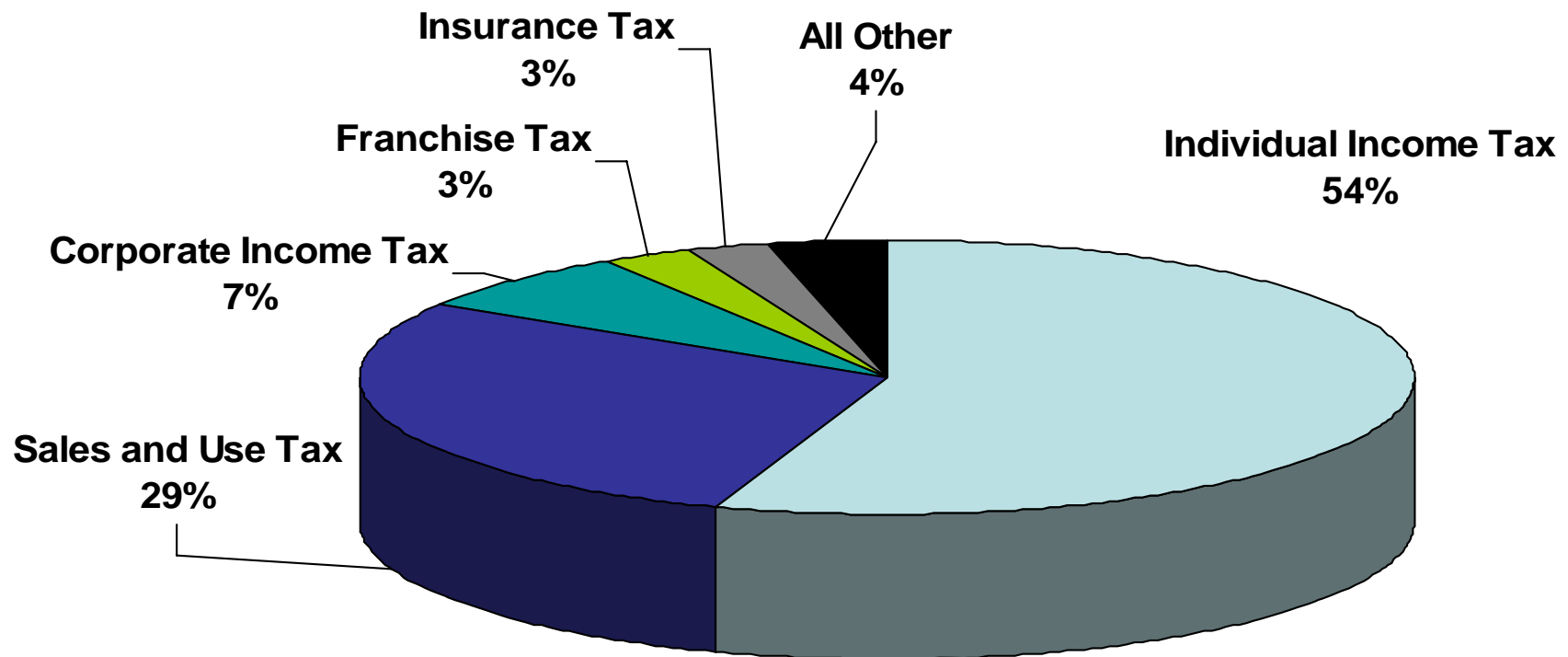
- Overall Collections
 - Tax v. Non-Tax
- Major Categories
 - Individual Income Tax
 - Sales & Use Tax
 - Corporate Tax
 - Franchise Tax
 - Other
 - Insurance Premiums Tax, Gift Tax, Estate Tax

General Fund Revenue by Source*



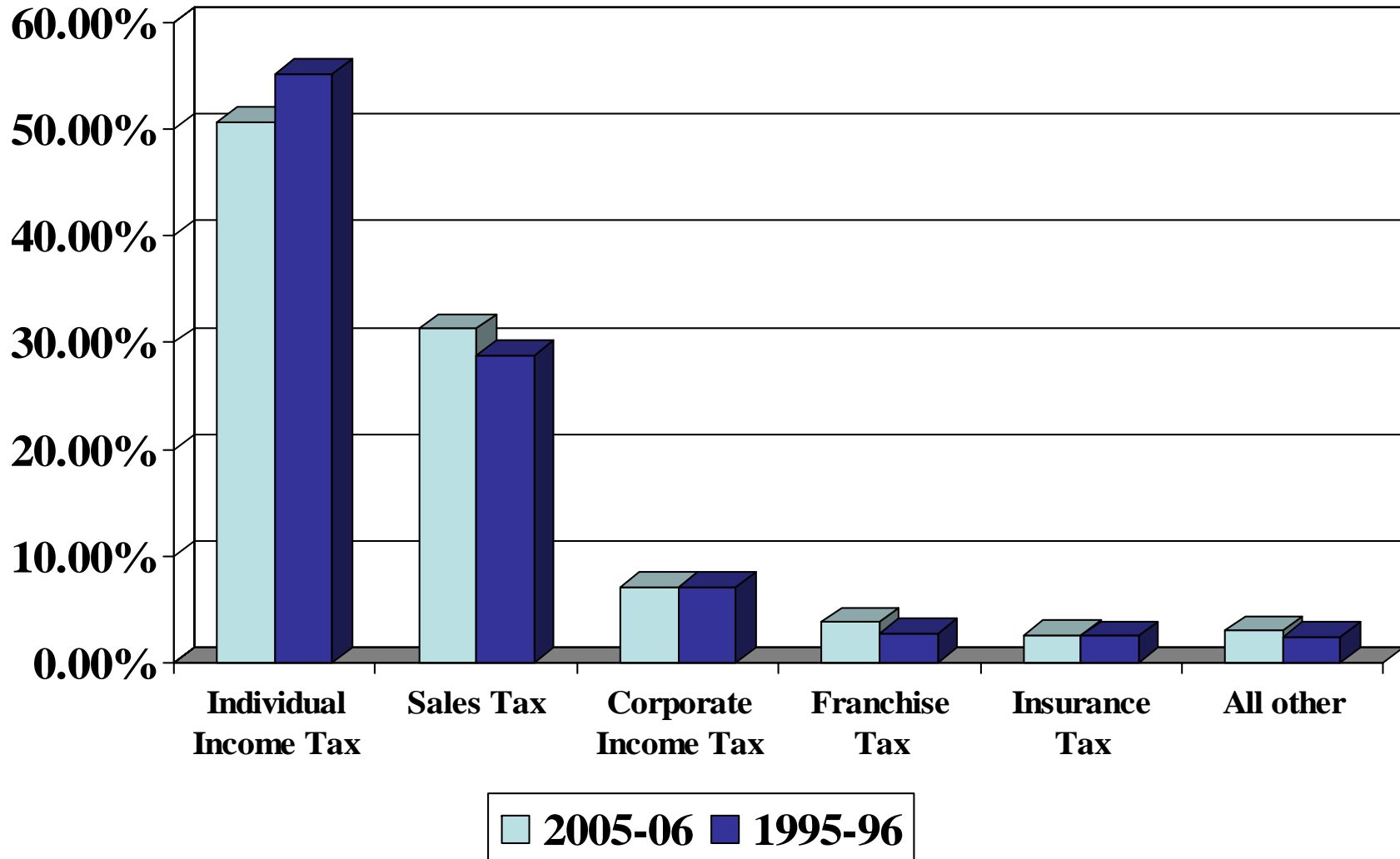
*Based on actual 2005-06 collections

General Fund Revenue Major Tax Sources (2005-06 Actual)

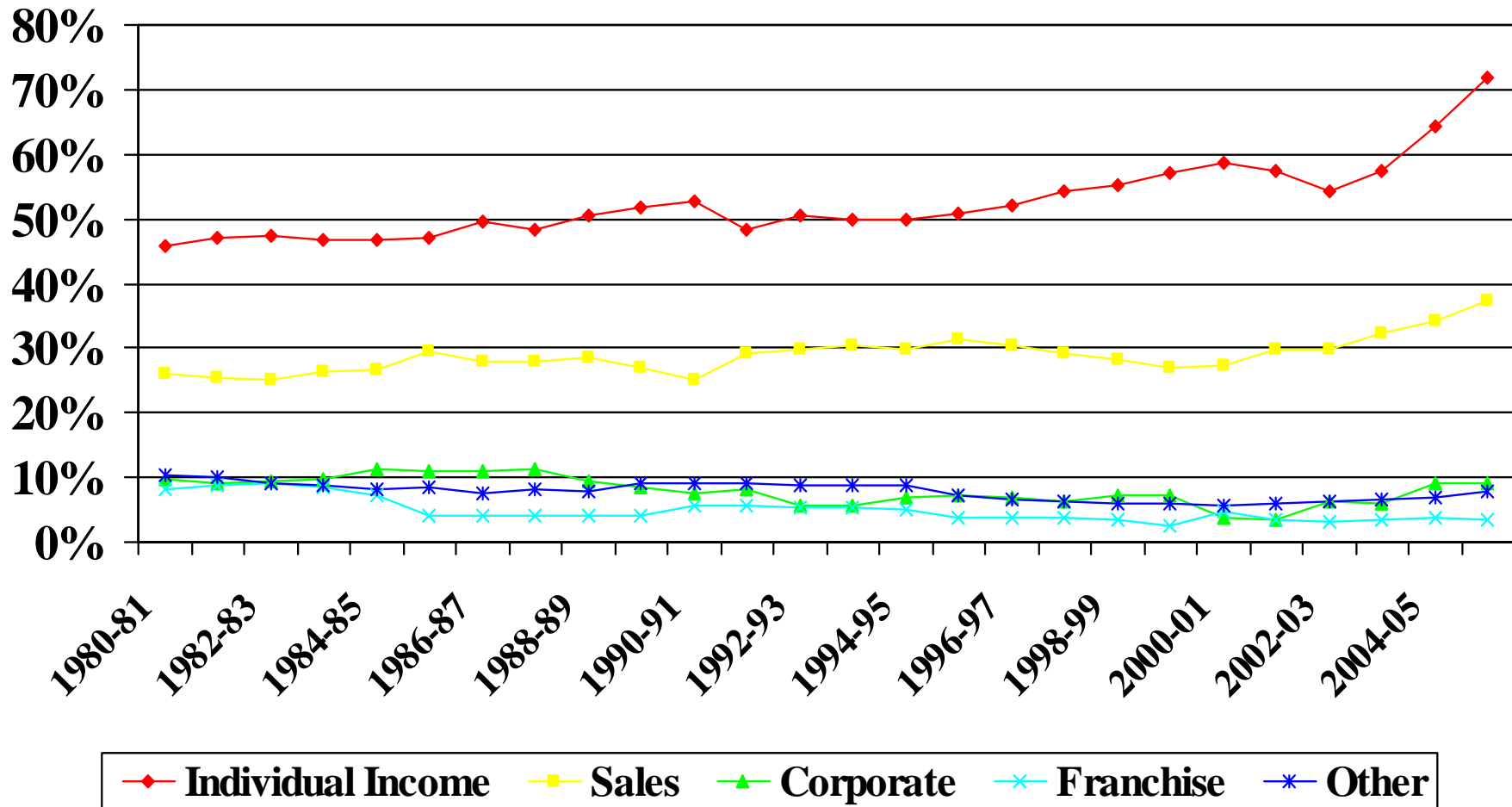


Total 2005-06 tax revenues: \$17.0 billion

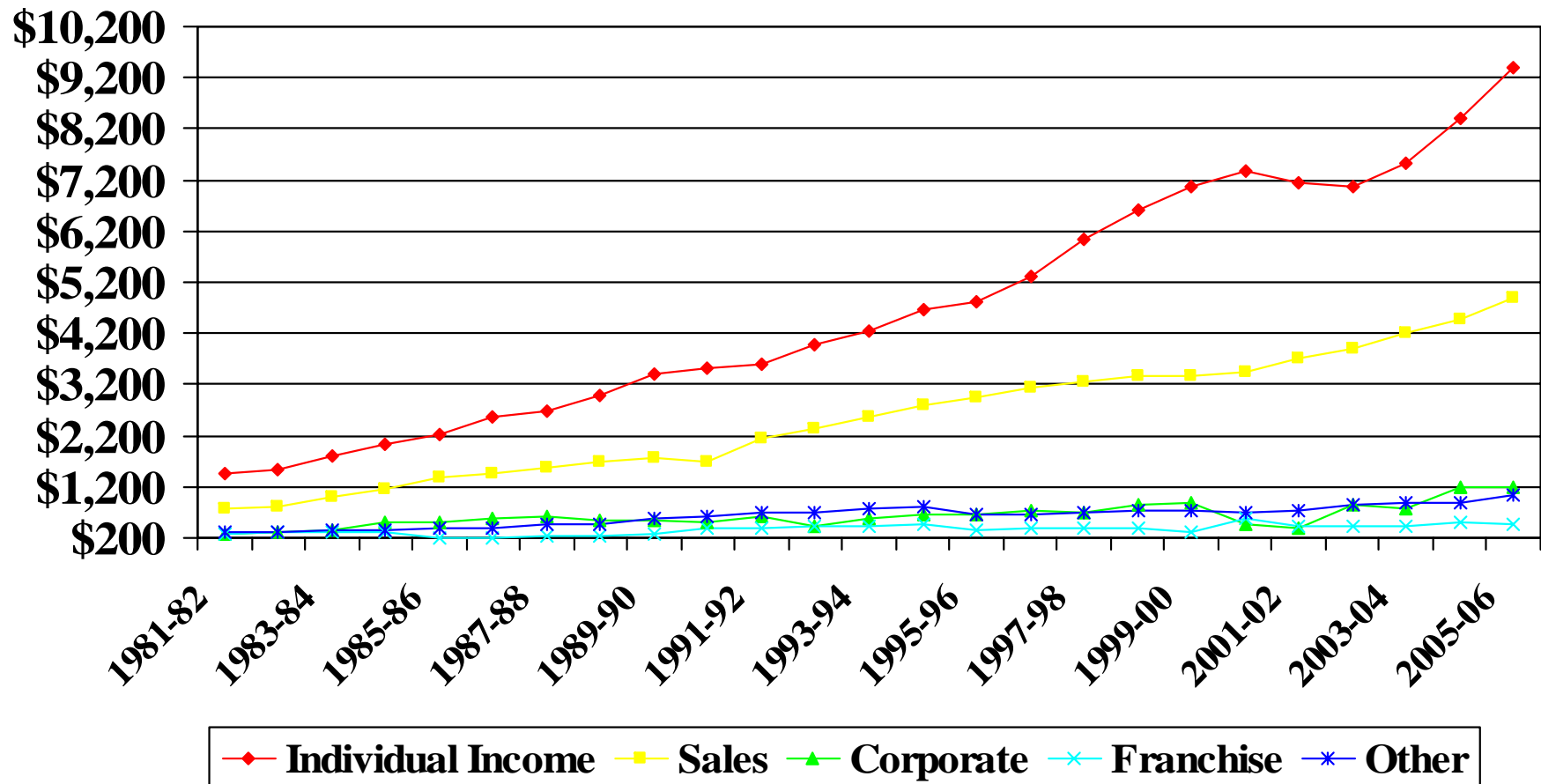
General Fund Major Tax Sources



Proportion of GF Revenues from Each Type of Tax

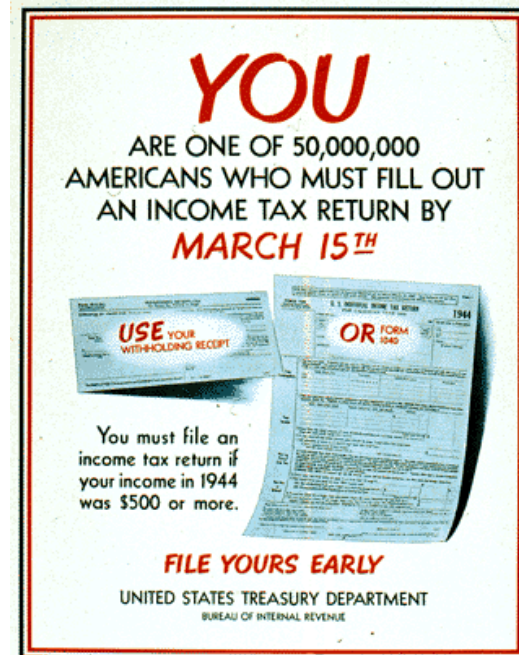


GF Revenues from Each Type of Tax (Actual Dollars, in Millions)



Individual Income Tax - History

- Imposed on a limited basis since 1849.
- Broad based tax established during 1921-37 period
 - Starting point for tax is federal taxable income (since 1989)
 - Reference to Internal Revenue Code updated annually
 - Limited major revisions
 - No indexing of standard deductions or personal exemptions



Individual Income Tax

Standard Deduction	<u>State</u>	<u>Federal</u>
Single	\$3,000	\$5,000
Head of Household	4,400	7,300
Married Filing Jointly	6,000	10,000
Married Filing Separately	3,000	5,000
Personal Exemption	2,500	3,200
>7.75% Tax Rate	2,000	3,200

*In addition, taxpayers aged 65 or over receive an additional \$1,000 deduction if married and filing jointly (\$1,250 single)

Individual Income Tax

State Income Tax Brackets for Tax Year 2007

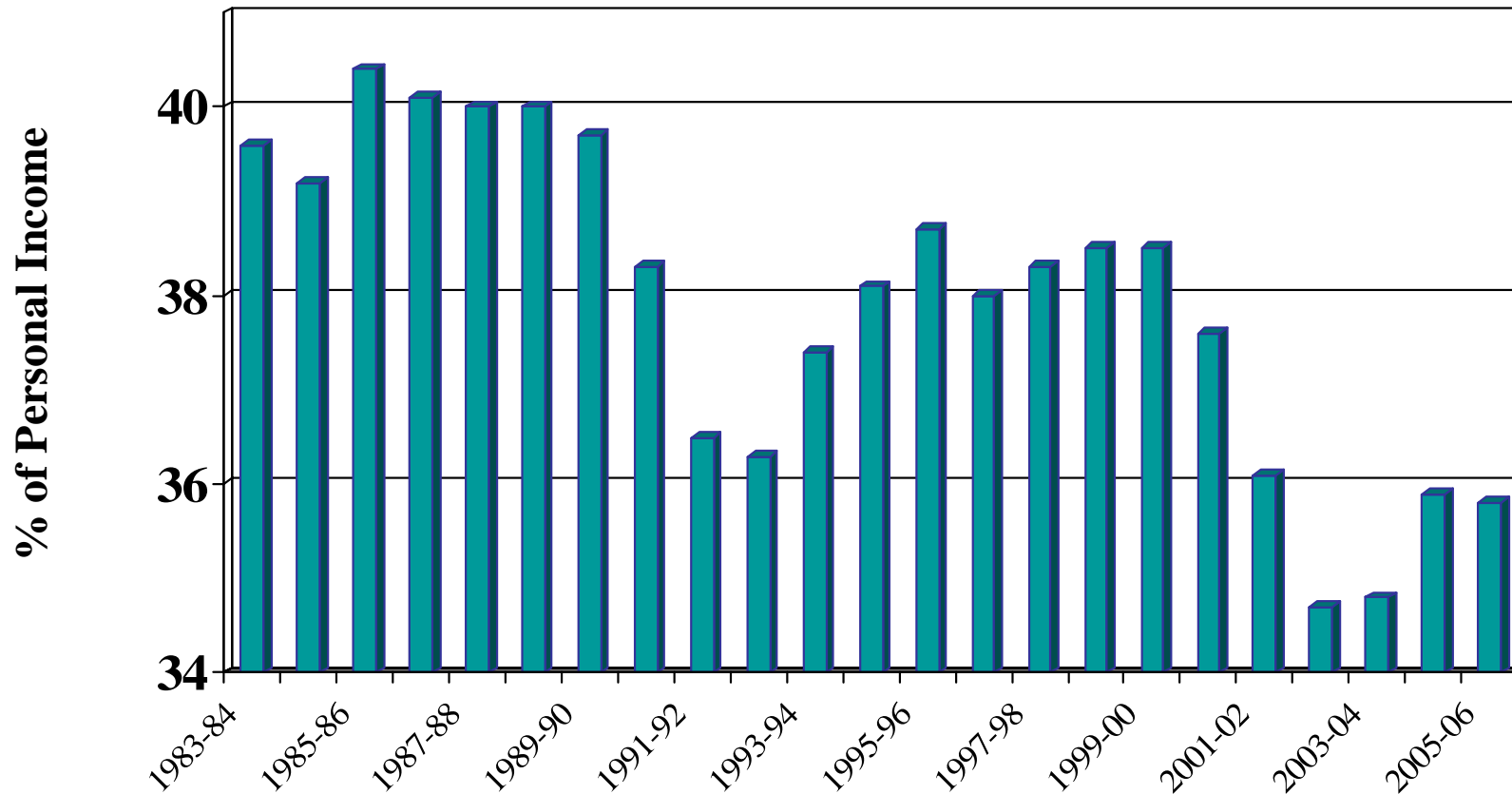
<u>Tax Rates</u>	<u>Taxable Income</u>			
	<u>6%</u>	<u>7%</u>	<u>7.75%</u>	<u>8.0%*</u>
Single	<\$12,750	<\$60,000	<\$120,000	\$120,000>
Head of Household	< 17,000	< 80,000	< 160,000	160,000>
Married Filing Jointly	< 21,250	<100,000	< 200,000	200,000>
Married Filing Separately	< 10,625	< 50,000	< 100,000	100,000>

*Rate will sunset to 7.75% effective January 1, 2008.

Sales Tax

- Collected from local merchants
- General state rate 4.25%
 - Under current law, rate will sunset to 4.0% July 1, 2007
- Relatively standard rate held up as example to other states
- Participation in Streamlined Sales Tax Project is forcing standardization
- Food is exempt from state tax but still subject to 2% local tax
- Distribution of sales tax to local governments is made on both per capita and point of sale basis

Local Sales Tax Base Relative to Personal Income (NC)

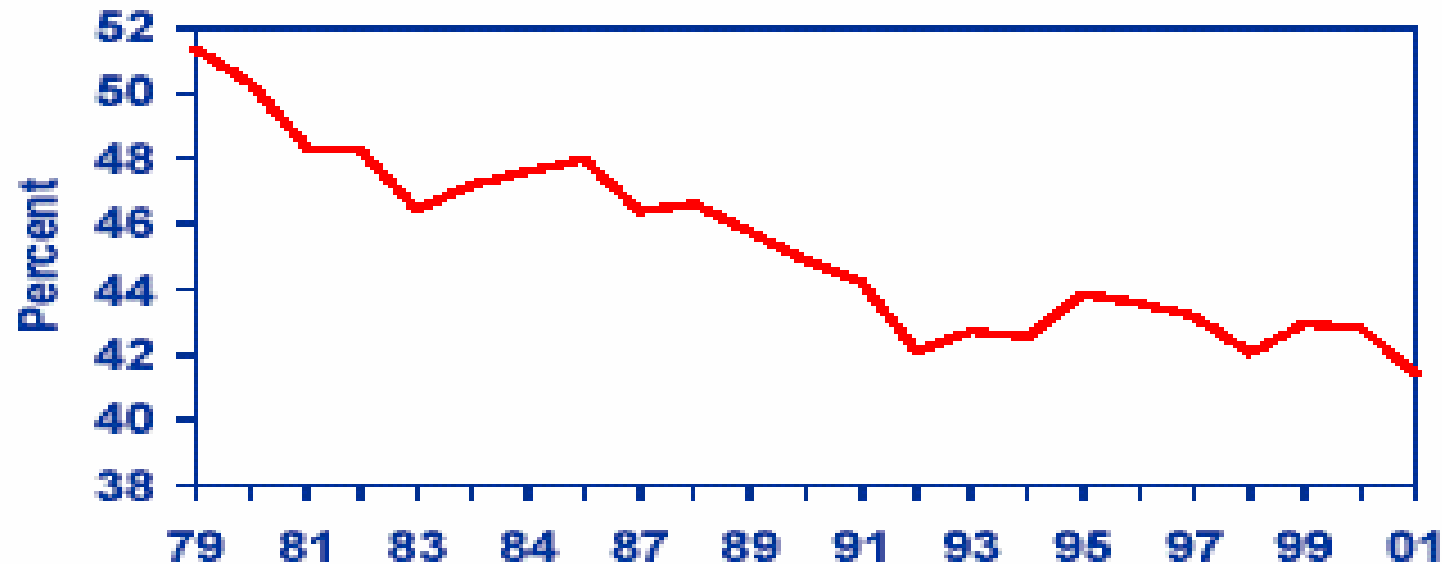


NOTE: Ratio calculated by converting 1% local sales tax receipts to a “tax base” and then dividing by personal income.

Sales Tax Base Erosion

NC Is Not Alone!

Sales Tax Base as a Percent of Personal Income, 1979-2001



Source: William Fox, *Three Characteristics of Tax Structures Have Contributed to the Current State Fiscal Crisis*, April 3, 2003.

State & Local Sales Tax Rates

Items	State tax rate	Local tax rate
Most tangible goods, room & cottage rentals, laundry & dry cleaning services, prepaid telephone calling services, mixed beverages	4.25%*	2.5%**
Food for home preparation	Exempt	2.0%
Motor vehicles, prescription drugs, other medical equipment, gasoline, many business purchases	Exempt	Exempt
Telecommunications services, spirituous liquor, cable & satellite television	6.75%***	Exempt
Electricity for general use***, sales of aircraft, boats	3.0%	Exempt
Manufactured/modular homes	2%/2.5%	Exempt
Purchases of select goods by manufacturers	1% or maximum of \$80 per item	Exempt

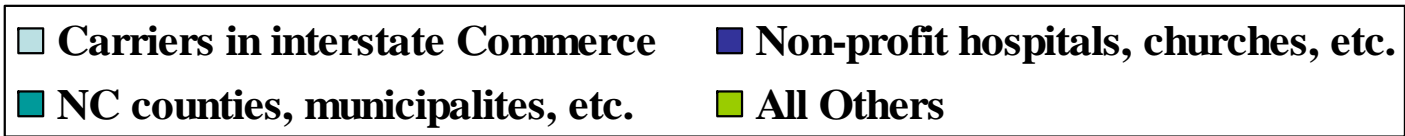
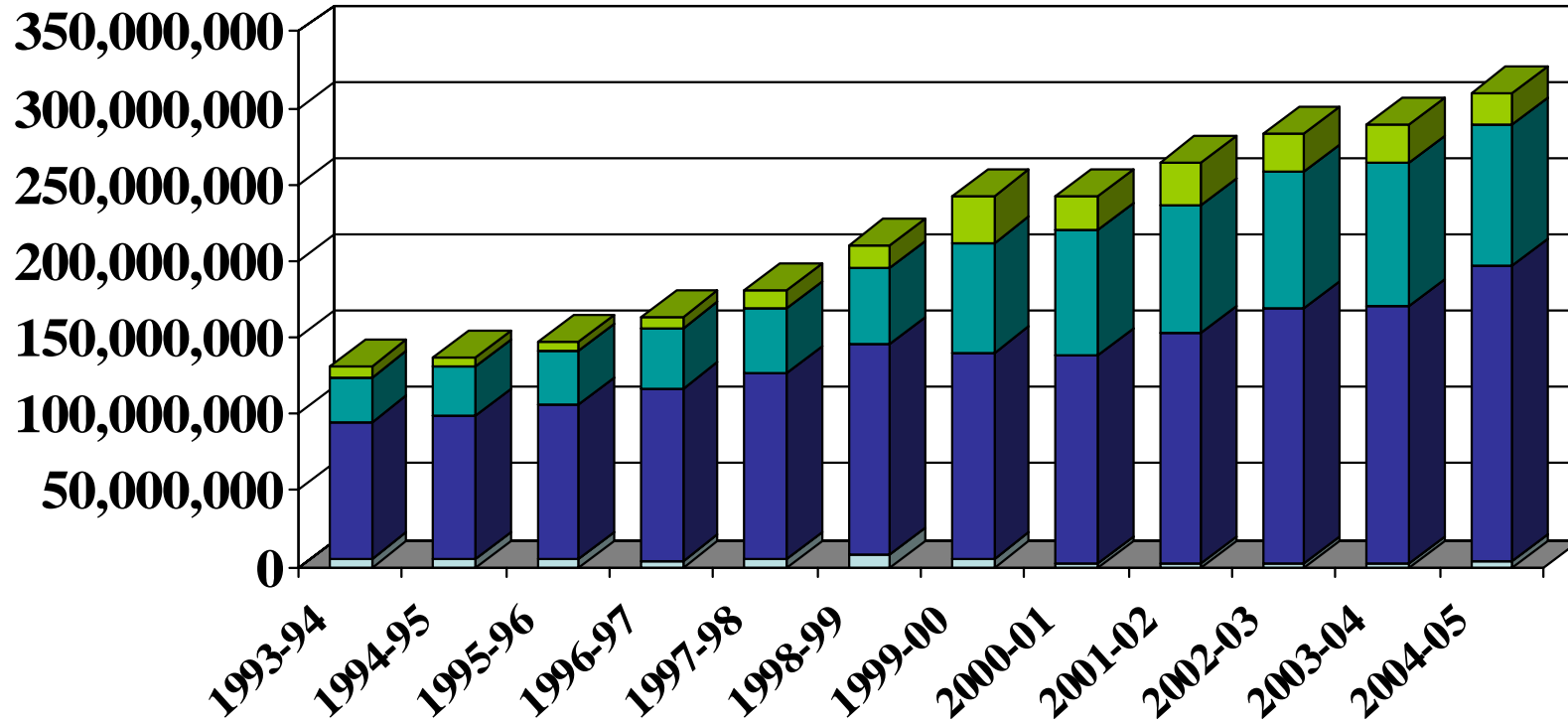
* Under current law, rate will sunset to 4.0% effective July 1, 2007

** Mecklenburg County has an additional 1/2% sales tax

*** The 6.75% rate represents the combined general State rate and local rate of tax that is authorized in all counties. Under current law, this rate will sunset to 6.5% effective July 1, 2007

**** Electricity sales to farmers, laundries, dry cleaners, and manufacturers are taxed at 2.6%

State Sales & Use Tax Refunds



Lottery Revenues

- NC Education Lottery commenced operations in March 2006
- Gross sales for FY 2006-07 through March '07: \$600 million
- By law, 35% of lottery revenues used to fund education
 - 50% to More At Four/Class Size Reduction
 - 40% to School Construction
 - 10% to Scholarships for Needy Students



Corporate Income Tax

- Imposed since 1921
- All domestic and foreign corporations doing business in North Carolina are subject to the tax
- Exempt corporations include:
 - S corporations
 - Insurance Companies
 - Telephone and electric membership corporations
 - Cooperative board without capital stocks
 - Nonprofits



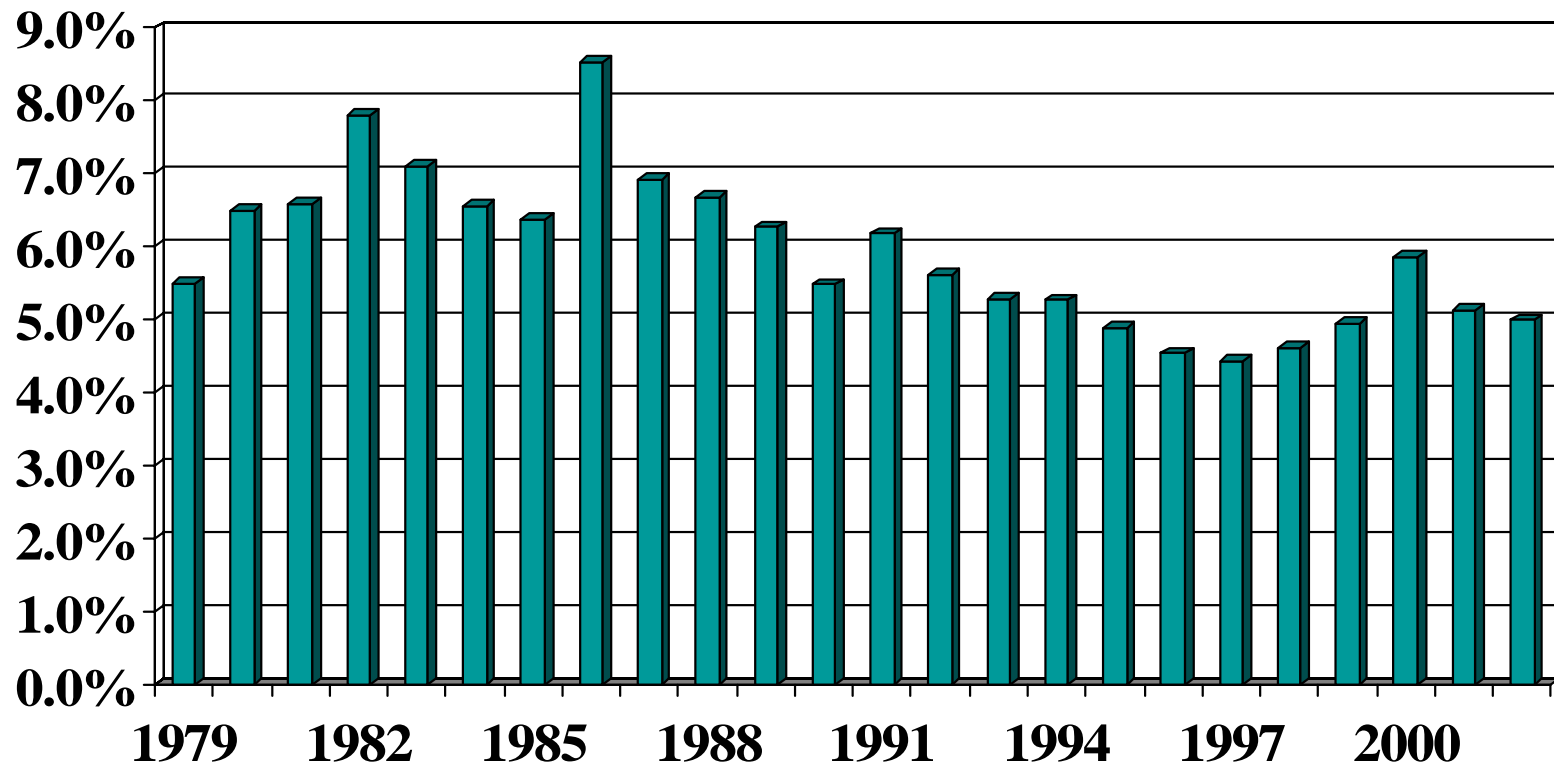
Corporate Income Tax

- Tax on state net income = federal taxable income
- Based on federal, but with numerous add-backs and deductions.
- Tax rate = 6.9%
- Key tests related to:
 - Apportionment
 - Nexus – Physical Presence Plus
 - General Base Erosion
- Effective Rate is Lower- especially for multi-nationals
- Numerous credits for specialized businesses, Bill Lee

Corporate Income Tax

Effective State Rate over Time (National)

■ Effective State-Local Corporate Tax Rate



Source: Steve Maguire, Congr. Research Service, "Average Effective Corporate Tax Rates: 1959 TO 2002, Updated September 5, 2003, as supplied by the Center for Budget and Policy Priorities (NCSL presentation).

Tax Credits & Incentives

- NC offers several tax credits & incentives to taxpayers, primarily those who make significant investments in business enterprises that contribute to the state's economic growth
 - Bill Lee Act – tax credits for investment in certain types of property, job creation, etc.
 - JDIG – grants (appropriations) for job development
- Credits can be controversial!
- Most apply to income tax, though some may apply to income, gross premiums, or franchise taxes

Franchise Tax

- Privilege or excise tax imposed on domestic and foreign corporations for the privilege of doing business and existing as a corporation under North Carolina law
- The franchise tax is measured by whichever of the following bases is greatest in amount:
 - Capital stock, surplus and undivided profits allocated to NC
 - 55% of the appraised value of real and tangible property or
 - investment in tangible property in North Carolina
- Tax is \$1.50 per \$1,000 (minimum tax is \$35)
- Closed loophole in 2001, 2002, and 2004 on the transfer of corporate assets to wholly owned LLC subsidiaries

Insurance Premiums Tax

- Tax on gross premiums of life insurance policies covering North Carolina residents and gross premiums of other insurance policies covering risks in North Carolina
 - 2.5% tax rate on Workers' Comp
 - 1.9% on annuities and all other insurance contracts
 - Additional 1.33% on fire and lightning coverage (except marine and auto)
 - HMO tax increased to 1.9% in 2005

Gift Tax

- Spouse is exempt
- Three classes of rates
 - A = Lineal (child, stepchild, adopted child) 1% to 12%
 - B = Brother, Sister, Aunt, Uncle 4% to 16%
 - C = All Others 8% to 17%
- \$11,000 exclusion annually (indexed to federal)
- \$100,000 per donor lifetime exemption
- \$16.3 million in FY 2004-05 (projected)

Estate Tax

- Regular death tax repealed effective January 1, 1999
 - 1999: Estate tax imposed in amount equal to federal state death tax credit (“Pick-up tax”)
- In recent years conformed to federal exemption limits but not federal phase out of the tax.
 - Federal government eliminated “pick-up tax” provision.
 - 2005: Conform to exemption limits but link to 2002 rates.
- Change allows state to recapture \$29.1 (05-06) and \$115.6 (06-07), but still a loss of revenue from previous.