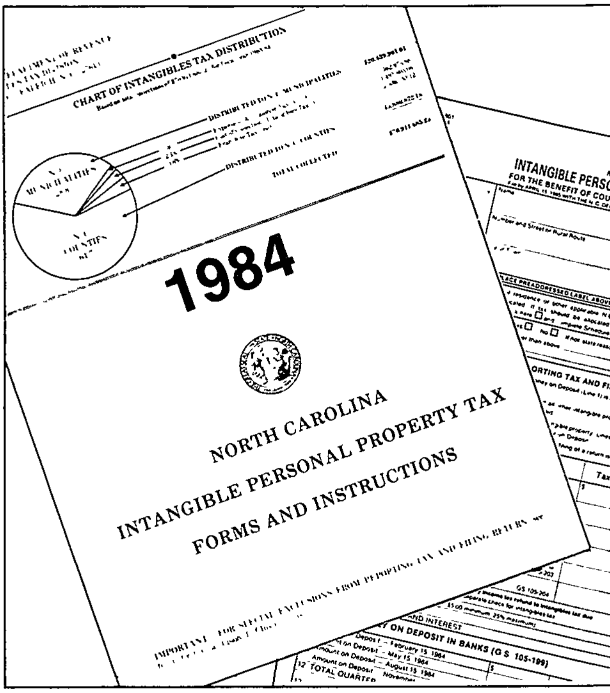
Pro —

The Intangibles Tax

Why it should be retained

by Sarah Denny Williamson



The intangibles tax is a property tax. It is a fair tax and it should be retained. Why? To understand, we need to first look at the background of property taxes.

Taxing property has long been the backbone of local government financing. *Real property*—land, homes, and buildings—has been taxed in North Carolina since 1777. *Personal property,* both tangible and intangible, has been taxed since the 1860s. Tangible personal property includes such items as automobiles, household furnishings, boats, farm equipment, etc. Intangible personal property includes stocks, bonds, notes, money market funds, mutual funds, and money on deposit.

City and county governments set their own rate of taxation on real property and on tangible personal property and collect those taxes at the local level. The same was true for intangible personal property taxes until 1937. That year the state took over collection and administration of the intangible personal property tax so there would be uniform tax rates on that class of property throughout the state. All taxes collected on intangible personal property (minus administrative costs and related franchise tax credits) are returned to the cities and counties for local government financing.

Why should this one type of property—intangible personal property—be exempted from taxation while the other two (tangible personal property and real property) continue to be taxed? Consider, for example, a person with $30,000 to spend or invest. Basically, he or she could invest the $30,000 in real property, such as a piece of real estate; in tangible personal property, such as a tractor or second-hand combine; or in intangible personal property, such as stock in a company.

If the investor chose real estate in the city of Raleigh, the property *tax would be $372* ($177, county and $195, city). For a tractor, the property *tax would be $177.* For the stock, the property *tax would be $0 to $75* (depending on where the corporation transacted its business). Yes, all of these are property taxes. And, yes, the investor would have to pay income tax on any income that came from the real estate, from the produce resulting from having the tractor, or from the stock dividends.

An investor has one obvious advantage in choosing intangible property over real estate or tangible personal property—the tax bill. In this example, an investor's taxes could range from $372 to zero. Moreover, the investor can support economic development in North Carolina while paying a reduced intangibles tax. If a company conducts 100 percent of its business in North Carolina, there is *no* intangibles tax on that company's stock. For a $30,000 investment in a company which conducts 84 percent of its business

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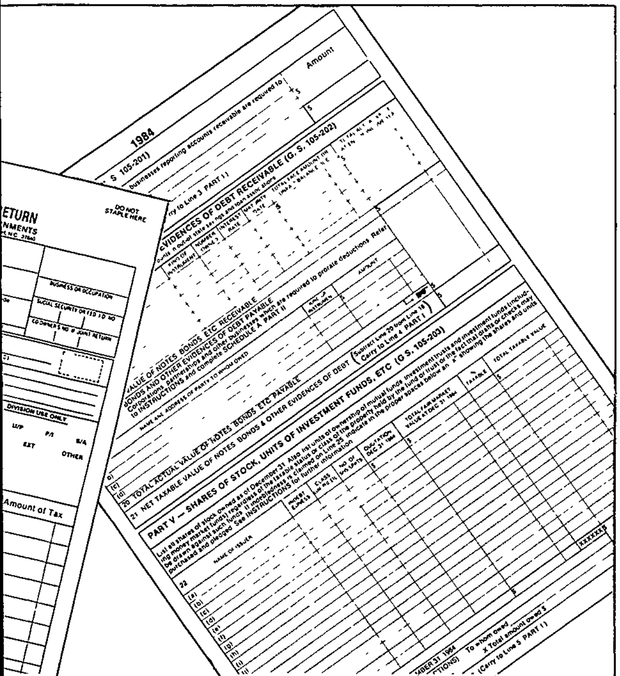
Sarah Denny Williamson, of Wake County, has paid intangibles taxes since 1959. She has testified on property taxes before committees of the N.C. General Assembly.



Con—

The Intangibles Tax

Why it should be repealed

by James Culberson

The intangibles tax is one of the least understood taxes in North Carolina, even though thousands of people pay this tax each year. Among all of the taxes that North Carolinians pay, including federal taxes, it is certainly one of the most unpopular. Repeated efforts have been made to have this tax repealed, and while changes have been made, the fundamental tax remains.

This tax is certainly not worth all of the time and money spent debating it over the past four decades. The roots of the modern-era debate lay in the turmoil of the Reconstruction Era. The Tax Research Division in the N.C. Department of Revenue traces the birth of the intangibles tax to 1868, when the state's new post-war Constitution broadened the property tax to include personal as well as real property. The 1868 Constitution directed that "a law shall be passed taxing, by uniform rule, all money, credits, investments in bonds, stocks, joint stock companies, or otherwise . . . ."

In 1921, the real debate began. North Carolina enacted a state income tax and gave up a statewide property tax. At that point, local governments got the levies from the intangibles property tax to themselves. Local tax jurisdictions set the same rates on intangibles as on other property, and the assessment ratio for intangible property was often higher than for real property. This resulted in a storm of protest. In 1927, the General Assembly considered a constitutional amendment calling for intangible property to be classified by the legislature at a uniform statewide rate. The amendment failed and the heavy levy on intangibles continued.

In 1937, the General Assembly approved a new constitutional amendment, approved by the voters two years later. It allowed the legislature to classify all property for taxation. The amendment led to the present intangibles tax law, which sets out the various assessment schedules and establishes fixed statewide rates for each component and exemptions for each. The law also places the responsibility for collection in the hands of the N.C. Department of Revenue. Most of the revenues, however, are still returned to the local government jurisdictions. In the fiscal year ending June 30, 1984, intangibles tax collections totaled $70.9 million, of which $66.3 million was returned to local governments.

Since 1937, the General Assembly has enacted changes in the intangible tax rates, in exemptions, and in distribution formulas. But the basic law continues. This historical context points out the antiquated nature of the intangibles tax. A tax of the "horse and buggy" days, it has survived into a modern era that has new and increasingly sophisticated investment vehicles. The law hasn't caught up with the times.

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James Culberson is chairman of the subcommittee on taxation of the N.C. Citizens for Business and Industry, and is President of First National Bank of Randolph County.

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in North Carolina, the intangibles tax would be $12 (the tax varies according to the percentage of business conducted in this state); for a company doing no business in this state, the tax would be $75.

Intangibles Tax is Equitable

Whether citizens pay real property tax, tangible personal property tax, or intangible personal property tax, they—as citizens—receive the same services provided by local governments: the public schools, the use of parks, paved streets, street lights, police and fire protection, water and sewer facilities, and more. Some say the intangibles tax is an unfair tax, but actually it is a very fair tax.

The intangibles tax represents a class of property, and property is a yardstick by which wealth is measured. Therefore, intangible personal property represents a class of wealth. Information gathered by the League of Women Voters of North Carolina reveals that "nationally, 88 percent of corporate stock is held by individuals with income over $60,000."[1] Why should this class of property be exempted?

Be Consistent — Address Money on Deposit

While the intangibles tax is fair, one element of the tax needs to be addressed. There are discrepancies in the levying of the tax on money on deposit. Currently, money on deposit in a commercial bank is taxed, but money on deposit in a savings and loan association or in a credit union is exempt from the intangibles tax.

There was a valid reason for the original exemptions — there were limits on what savings and loan associations and credit unions could do. Now with bank deregulation, those limitations have been removed, but savings and loans and credit unions still enjoy the benefits of the exemption. That is not fair. Banking institutions providing similar services should be treated alike.

"It is not a tax bill but a tax relief bill providing relief not for the needy but for the greedy."— Franklin Delano Roosevelt

To address this issue, the legislature could:

- add the tax to savings and loan associations and credit unions (politically unlikely during a session when tax *cuts* are popular);
- eliminate the tax entirely on money on deposits, at a cost of $19.4 million; or
- raise the threshold on money on deposits so as to reduce the impact of the tax on persons with relatively small amounts of money on deposit.

While this discrepancy does need attention, it does not affect the overall fairness of the intangibles tax.

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Inconsistencies in the Tax

The intangibles tax is based on antiquated concepts that no longer apply to the modern era. It does not apply fairly to all forms of investment. For example, deferred annuities, electronic transfer of funds, and other types of computer-oriented investments have entered the finance world faster than the intangible tax law can be amended properly to insure fairness in the law. Television and mass-mail marketing now make possible out-of-state sales of goods and services by merchants who reap the the benefit of the North Carolina market but do not pay intangibles tax on the money they generate.

The changing nature of the investment world has resulted in many inequities in this tax. Specific examples include:

- the current law requires that taxes be paid on bank deposits but not on deposits at savings and loans, credit unions, and other thrift institutions;
- deposits in money market funds administered by investment firms such as Merrill Lynch are exempt from intangibles tax up to $6,000 while the deposits in banks are taxable starting at $1,000.
- merchants with all cash sales must pay a tax on their cash balance with no offset from their accounts payable, *but* merchants doing business on credit can offset accounts payable against their receivables;

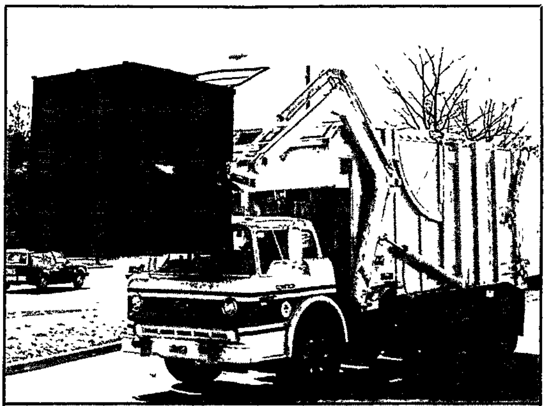
Industrial Development Not Hampered

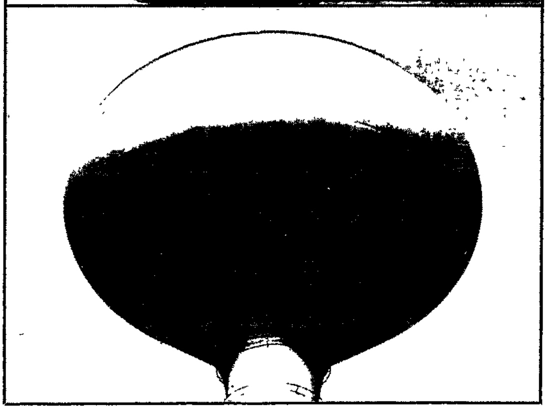
There are those who claim that the intangibles tax hinders industrial development in North Carolina. There is absolutely no research or any other kind of evidence to support that claim. Moreover, the facts are to the contrary. Between 1977 and 1984, industries invested $15.5 billion in North Carolina, creating more than 250,000 jobs. Thomas B. Broughton, director of the Business Assistance Division in the N.C. Department of Commerce, said that in 1984, "investments by new and expanding industry, which includes land, building, and equipment, totaled $2.671 billion and created 46,821 industrial jobs."[2]

These industrial investments, as in recent years, reveal continuing diversification. Broughton notes that in 1984 North Carolina also led the nation in attracting *foreign* industries expanding into the United States. "Without question," Broughton said, "North Carolina should continue as a leader in economic development."

The intangibles tax has not hindered this economic growth. Mark Lynch, former N.C. Secretary of Revenue, summarized the burden of this tax on corporations in a report for the 1984 General Assembly. "A sample of large manufacturing companies in North Carolina shows their intangibles tax liabilities to be less than 0.1 of 1 percent of their net income before tax, or an average of about $545." Is this amount of tax going to keep a company from locating here? Of course not.

B. E. Dail, director of the Tax Research Division in the N.C. Department of Revenue, addresses the same issue in this way. "A sample of large manufacturing companies now in North Carolina shows their intangibles tax liabilities to be less than 0.1 of 1 percent of their income





- individuals who have borrowed money to use for a specific purpose—but have not yet disbursed those funds by the intangibles tax assessment date—are taxed on those funds even though they are borrowed money.

Inequities in the Tax

Proponents of this tax contend that in order to be equitable, the value of stocks and bonds should be taxed if real estate is taxed. What that overlooks are the extensive public services, such as streets and police and fire protection, that are required in connection with the real estate investment. A stock and bond portfolio requires no service from the city and county.

Capital Formation Thwarted

Since the Civil War, North Carolina has been plagued by a shortage of capital. North Carolina industries have had to import capital in order to expand. Although the economy has expanded since World War II—primarily because of favorable labor conditions—we still have had to import capital to sustain the growth.

The intangibles tax is a tax against capital. It discourages capital from coming into our state. Our great investment in the Research Triangle Park should result in new companies that spin off from the development at the park into other parts of the state. But this is not happening the way that it should. According to the Winthrop Rockefeller before taxes. If smaller manufacturing companies have similar proportional liabilities, it seems doubtful that industrial location decisions would hinge on this level of relative tax liability."[3]

Finally, in recent surveys by *Business Week* and *Fortune*, industrial managers across the country rated North Carolina as among *the most desirable states for new plants.*[4] Corporations look at the total picture—at the schools and universities, the labor force, roads, water and sewer systems, and the cultural opportunities, as well as the tax structures. They look at the "quality of life."[5]

Retirees Not Deterred

The assertion that the intangibles tax keeps away retirees is equally unfounded. The same "quality of life" that attracts industry also attracts retirees.

Catherine LaTour, reference librarian at the American Association of Retired Persons (AARP), when asked about the effect of the intangibles tax on retirees relocating, said, "We get calls asking about taxes in general, whether [a particular state] is a nice place to live, that kind of thing. The tax questions are about income tax, usually. I can't remember a question about the intangibles tax."

From Brevard in the mountains to Southern Pines in the Piedmont to Wrightsville Beach on the coast, retirees are settling in North Carolina. Newspaper and magazine coverage around the state suggests the importance of low taxes for the migration of retirees to North Carolina.

The News and Observer of Raleigh, for example, on March 20, 1983, profiled two couples who had moved to the state—one from New Jersey, the other from New York. The couple from New Jersey paid about one-fifth as much property tax in Southern Pines as they did in Montclair. The other couple said their property and school taxes in western New York state were about $3600 a year. In Hendersonville, their property taxes were about $300. To put it

Where Does North Carolina Rank for Attracting Retirees?

by Bill Finger

Very little data exists on exactly what attracts retirees to another state. And when it comes to the intangibles tax, the research is even thinner. "It is virtually impossible to measure the actual response [of retirees] to repeal [of the intangibles tax], however, because no data are available to show . . . how many individuals chose another state solely because of the intangibles tax," wrote B.E. Dail, director of the Tax Research Division, N.C. Department of Revenue, recently.[1]

In two studies on what attracts retirees, North Carolina ranked 7th and 12th. The Center for Social Research in Aging at the University of Miami at Coral Gables analyzed the

Foundation, of the four states with nationally recognized research parks (including North Carolina), the other three (California, Massachusetts, and Texas) have received 99 percent of the investment capital going to these parks.[1]

Retirees Go Elsewhere

Time and time again, the argument has been made that we are losing retirees who are reluctant to come to North Carolina because of the intangibles tax. And yet, North Carolina is considered one of the best states for retirement. From first-hand experience as a banker in the retirement area of Southern Pines, it appears that the retirees who come to North Carolina may be those who are

primarily dependent on income from pension plans rather than from investment portfolios.

In addition, when retirees settle in adjoining states to take advantage of a lower tax rate, we lose out on a significant increase in the ad valorem tax base. While no one has researched this issue, the additional ad valorem, state income, sales, and another way, North Carolina ranks 46th in per capita property tax burden, and that includes the intangible tax and the inventory tax.

Now, what about Florida, the state noted for attracting retirees? Florida has an intangibles tax. But it *does not have an individual income tax*, and its estate tax is much lower than North Carolina's inheritance tax. Florida also has warm weather, hundreds of miles of beaches, numerous retirement villages, and other attractions for retirees. All of these factors, taken together, determine where retirees move, not the intangibles tax alone.

Tax Doesn't Hurt North Carolina's Border Counties

Some people claim that the intangibles tax hurts rural, border counties, because neighboring states have lower taxes. These critics of

1980 U.S. Census data and found North Carolina ranked 7th in attracting people 60 and over.[2] The Census asked, "Did you live in a different state in 1975?" Based on this question, the top ranked states (and the ranking of states bordering North Carolina) were:

	State	Number Over 60 Who Said They Lived in a Different State in 1975
1.	Florida	437,000
2.	California	145,000
3.	Arizona	95,000
4.	Texas	78,000
5.	New Jersey	49,000
6.	Pennsylvania	40,000
7.	**North Carolina**	**39,000**
11.	Virginia	34,000
14.	Georgia	33,000
16.	Tennessee	29,000
25.	South Carolina	20,100

In a study done for *MONEY* magazine in 1979, Chase Econometric Associates Inc. ranked North Carolina 12th.[3] These analysts examined 10 factors and attached hypothetical "values" to each. The factors, with the "value" of each in parenthesis, were: metropolitanization (20), weather conditions (15), unemployment (10), housing (10), utility rates (10), nonmanufacturing employment growth (10), ratio of elderly to working-age population (10), property tax loads (10), living costs (10), and growth of retired population (5). Totaling the hypothetical values (excluding Hawaii and Alaska), the top ranked states (and the ranking of states bordering North Carolina) were:

	State	Rating		State	Rating
1.	Utah	305	8.	Arizona	175
2.	Louisiana	295	9.	Florida	160
3.	South Carolina	280	10.	Georgia	155
4.	Nevada	260	11.	Colorado	140
5.	Texas	230	**12.**	**North Carolina**	**110**
6.	New Mexico	200	13.	Tennessee	100
7.	Alabama	185	15.	Virginia	75

FOOTNOTES

1 B.E. Dail, "An Analysis of Possible Modifications or Repeal of the Intangibles Tax," Property Tax Bulletin, published by the Institute of Government, University of North Carolina at Chapel Hill, No. 70, February 1985, p. 3.

2 Charles Mangino et. al., *Retirement Migration Project: A Final Report to the National Institute on Aging*, Center for Social Research in Aging, University of Miami at Coral Gables, Table 2, p. 14. The study includes charts comparing North Carolina with other states. Copies are available for $30.00 (P.O. Box 248092, Coral Gables, Fla. 33124).

3 For a good summary of the study, see Raymond Schuessler, "Best States to Retire To," *Modern Maturity*, October-November 1981, pp. 57-61.

other tax revenues might well exceed the income lost from repeal of the intangibles tax.

More and more, retired persons depend on dividends or interest from stocks and bonds, which exacerbates a kind of double taxation—a 7 percent state income tax rate (on the dividends and interest) *and* a levy on the value of the investments.

Most Neighboring States Don't Have the Tax

Among the 50 states, many have recognized that this is an antiquated and unfair tax and have repealed it. Now only seven states have both an intangibles tax and an income tax, and one of them (Indiana) is in the process of phasing the intangithe intangibles tax claim that tax differentials encourage corporations that might move to North Carolina to settle just across the border. There is no basis for this contention. Taxes do not differ markedly among North Carolina's neighbors—Virginia, Tennessee, Georgia, and South Carolina.

The April 2, 1984, *U.S. News and World Report* listed the per capita state and local property taxes for 1982. And remember, North Carolina's figure includes intangibles and inventory taxes. The U.S. average was $362, with such states as New Jersey ($591), New York ($574), and Massachusetts ($510) at the top. For North Carolina and its border counties, the per capita totals were: Virginia, $300; Georgia, $254; North Carolina, $206; South Carolina, $200; and Tennessee, $195. Eleven dollars less per person, per year in property tax is not going to send anybody to Tennessee, nor $6 less to South Carolina.

Maybe the reason rural, border counties are not drawing industry is not the intangible tax but a lack of water and sewer systems. "Some 140 communities have a moratorium on construction because wastewater treatment facilities are inadequate," says S. Leigh Wilson, executive director of the N.C. League of Municipalities. "Without new sources of funding for such facilities, economic growth is stymied in these communities."

Many of these communities are located in the rural, border counties. Just look down a recent list: Lake Waccamaw and Chadbourn in Columbus County; Spruce Pine in Mitchell County; Fairmont, Saint Pauls, and Red Springs in Robeson County; and Hendersonville in Henderson County. The list goes on and on. It is not the intangibles tax that is hurting the rural, border counties.

Local Governments Will Be Hurt by Repeal

The intangibles tax helps finance local government services. In FY 1984, the state returned $66.3 million to cities and counties from intangible tax revenue collections. This amounted to about 3 percent of total local government budgets. These funds go into the basic operating budgets of counties and municipalities across North Carolina.

Some people still cling to the belief that it will be okay to repeal the intangible tax if the revenue to the cities and counties is replaced. But there are fallacies to this theory. First of all, if the state replaces the money by paying the cities and counties from its General Fund, then the state is taking money paid to the state by all taxpayers, largely through income and sales taxes, in order to give a property tax break to those few taxpayers who no longer would be paying any tax on a certain class of property. And it is a small class indeed.

According to Mr. Lynch's 1984 report, 3.5 million income tax forms were filed by individuals and corporations for 1982, but only 195,000 intangible tax returns were filed. This would be exempting a few from a tax that is fair and reasonable and shifting their responsibilities to all.

In addition, even if the General Fund absorbs the lost revenues, local governments will be hurt, especially when seeking help for critical needs like water and sewer facilities. Furthermore,

bles tax out (see chart on page 6.) Two other states, Georgia and Kentucky, have a lower income tax and intangibles tax rate than North Carolina.

Protect the Local Governments

The proposals before the General Assembly to repeal this tax recognize that cities and counties should be protected from the the potential loss of revenue. The need for these revenues by local governments is well documented. Provision for the replacement of the funds should be part of any legislation to repeal the intangibles tax.

Repeal the Tax in 1985

A "horse and buggy" tax and the electronic age are not compatible. Repeal is the only solution, especially for a tax so unpopular as the intangibles tax. In summary, this tax needs to be repealed because it:

1) is not equitable because it is assessed against capital and cash which do not require services from the community as compared to ad valorem taxes;

2) is inconsistent in its application, not covering, for example, funds in the many new tax shelters of the modern electronic age;

the amount of intangible tax paid to cities and counties has been increasing each year. If a cap were put at any time on reimbursement payments to the cities and counties, then the cities and counties would not be realizing the fruits of their growth. From 1983 to 1984, the amount of intangibles tax returned to local governments increased 17.2 percent.

Also, the cities and counties would be losing a right that they have had since the 1960s—that of taxing their citizens on all three classes of property. And the "so-called compensation" would not be a reimbursement of the tax, for that tax would no longer be collected; it would simply become in reality "state revenue sharing." Is that what we want? And what the legislature gives, any session of the General Assembly can take away. We know that from federal revenue sharing. Where would that leave city and county governments?

"If there is no satisfactory state aid, and local property taxes are used as a replacement [for intangibles tax revenue], county [property tax] rate increases would average about 4.5 percent, based on 1982-83 figures." reports B. E. Dail.

Keep the Tax Alive in '85

The intangibles tax does not hinder economic development. It does not keep retirees from settling in North Carolina. And it does not hurt rural, border counties. Whether to repeal this tax is purely and simply a debate over whether to exempt one class of property or wealth from taxation while the other two classes of property and wealth carry their load. Who can call that fair? □

FOOTNOTES

[1] *State and Local Tax Revolts*, Conference on Alternative State and Local Policies, Washington, D.C., 1980, p. 204.

[2] Interview with Thomas Broughton, February 1985, and "Industry Development Diversifies," by Broughton in *The News and Observer* of Raleigh, February 3, 1985, p. 27G.

[3] B. E. Dail, "An Analysis of Possible Modification or Repeal of the Intangibles Tax," *Property Tax Bulletin*, published by the Institute of Government, the University of North Carolina at Chapel Hill, No. 70, February 1985, p. 3.

[4] *Why Corporate America Moves Where*, May 1982, prepared for Belknap Data Solutions, Ltd., as a *Fortune* market research survey; and *Plant Site Selection: A Survey of Management Subscribers in Industry*, September 1984, by McGraw-Hill Research at the request of *Business Week* magazine.

[5] For more information about how tax policy affects industrial recruiting, see the article on inventory taxation by Jane Sharp and Jan Ramquist. Other sources, which show industrial location decisions are based on factors other than taxation, are:

Locating Industry in Arkansas: York Hanover—A Case Study in Public Incentives, 1984, The Winthrop Rockefeller Foundation, 308 E. 8th Street, Little Rock, Ark., 72202;

State Tax Policy: Evaluating the Issues, 1983, Joint Center for Urban Studies, Massachusetts Institute of Technology and Harvard University, by Andrew Reschovsky, p. 166; and

Taxes and Growth: Business Incentives and Economic Development, 1981, The Council of State Planning Agencies of the National Governors' Association, by Michael Kieschnick.

3) is detrimental to capital formation which is of utmost importance in the further growth of North Carolina;

4) discourages many retirees from moving to North Carolina, resulting in a loss of ad valorem and other state taxes that might exceed the revenue currently generated by the intangibles tax;

5) is not imposed as heavily by neighboring states;

6) yields some $80 million annually, which will be absorbed (under current proposals) by the state's General Fund, not local governments; this is

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an insignificant amount relative to total state and local taxes and to the administrative cost of collection. □

FOOTNOTES

[1] *Responsible Choices in Taxation—The Corporate Contribution*, published 1984 by the Winthrop Rockefeller Foundation, 308 East Eighth Street, Little Rock, Ark. 72202.