



Rendering Unto Caesar

A Taxing Problem for the 1985 Legislature

by Jack Betts

For more than two centuries, North Carolinians have debated what constitutes a reasonable and a fair tax. At the heart of the debate—which sometimes rages and sometimes merely whimpers—are questions of fairness and, more to the point, whether the next taxpayer is paying a fair share. Those same questions will be raised in this 1985 session of the General Assembly over proposals by Gov. Jame G. Martin to provide more than a billion dollars' worth of tax relief during the next four years.

The state's legislative history is littered with proposals to derive a fair system of taxation that will also provide enough revenue to fund state services and create a favorable climate for eco-

nomic growth. Before the American Revolution, the colony raised revenues through poll taxes, an extremely unpopular levy, and certain types of land rents. In 1777, the state's first legislature elected by the people engaged in a great debate over taxation and adopted the principle of universal taxation of property. And the 1839 General Assembly adopted the notion of a balanced tax system. The system we have today in North Carolina sprang largely from those debates.

Governor Martin is but the latest in a long string of chief executives to discover that when it

Jack Betts is associate editor of North Carolina Insight. Artwork and photographs by Carol Majors.

comes to taxes, forging an agreement on who should be taxed—and by how much—is far easier in theory than in reality. In his February 28, 1985, State of the State address, Martin proposed a sweeping series of tax changes: repealing the sales tax on food by January 1986; dropping the sales tax on non-prescription drugs by January 1986; phasing out the property tax on inventories held by manufacturers, wholesalers, and retailers (from January 1986 through 1989) through a series of corporate tax credits; and eliminating the state tax on intangible property like stocks, bonds, and money on deposit by January 1986. (For more, see "What's in a Tax?" on page 4.)

The cost of this tax relief would come to \$70.3 million in the first fiscal year but balloon to \$258 million in the second year, \$362 million in the third year, and nearly half a billion dollars (\$489 million) by the fourth year. It all adds up to \$1.2 billion in tax relief over Martin's four-year term.

Martin swept into office last fall after campaigning for those tax cuts. During the campaign last year and again in his appearance before the General Assembly, Martin preached the gospel of cutting those taxes because they are "virtually unique, self-inflicting handicaps" that cut personal income, stifle economic growth, and discourage out-of-state manufacturers and retirees from relocating here.

What made Martin's proposals particularly appealing was his contention that his tax program could be effected without major spending cuts and without raising any other taxes. Not only that, Martin promised, but the state would also guarantee that county and city governments, which are the

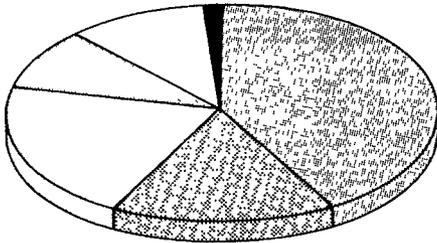
"And it came to pass in those days, that there went out a decree from Caesar Augustus, that all the world should be taxed."—Luke 2:1

main beneficiaries of the intangible and inventory taxes, would suffer no loss of revenue. In fact, they would gain revenues in future years through general economic growth.

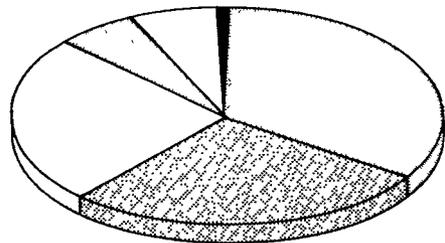
Democrats in the legislature immediately predicted there wouldn't be enough growth in the current budget to pay for all the tax cuts. And they warned that federal budget cuts proposed by President Ronald Reagan could cost the state further

Tax Revenue Sources

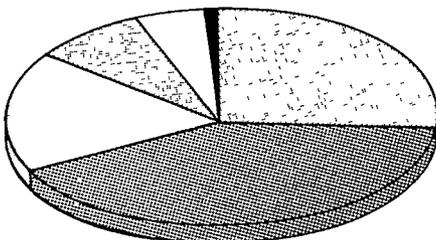
1963-64 General Fund



1973-74-General Fund



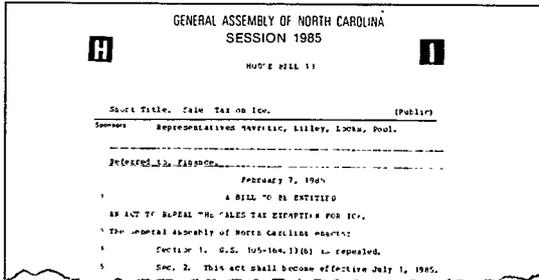
1984-85 General Fund



- Other Taxes
- Franchise Taxes
- Corporate Income Tax
- Inheritance Tax
- Sales Tax
- Personal Income Tax

Source: N.C. Department of Revenue

funding. The Governor dismissed those fears, however, saying the state should not postpone tax reductions "on the remote, hypothetical possibility that federal spending is going to be cut substantially."



But Martin, only the second Republican governor since the turn of the century, may not enjoy the success in the General Assembly that he enjoyed at the ballot box in November. Despite major GOP gains, the legislature remains solidly in Democratic hands, with the GOP outmanned 120 to 50. A February survey of legislators by *The*

Charlotte Observer found broad support for some of Martin's proposals—particularly repeal of the intangibles tax—but less support for removal of the state sales tax on food.

Governor Martin's proposals are not, of course, the only tax relief measures to come before the General Assembly. In the first two weeks of the 1985 session alone, no less than a dozen tax bills were introduced by Democrats, and more were coming in daily. Among the major proposals were:

- A bill by Sen. Kenneth Royal (D-Durham) and others to increase state sales and use taxes by .5 percent; provide an individual income tax credit; exempt money on deposit from the intangibles tax; and establish a reserve account for capital construction for public schools.

- A bill sponsored by Sen. Dennis Winner (D-Buncombe) to exempt money on deposit from the intangibles tax and reimburse local governments for the loss; and to allow counties to exempt business inventories and intangible property from taxation.

What's In a Tax?

Exactly what are the taxes that Gov. James G. Martin proposes to eliminate? And how much revenue do they bring in? The General Assembly's Fiscal Research Division has supplied figures for those revenues. For Governor Martin's estimate of revenue loss, if his tax proposals were approved, see the chart on page 5.

Sales Taxes: that portion of the 3 percent statewide sales tax that is levied on food and non-prescription drugs.¹ Often called the most regressive of taxes, the food tax applies equally to every consumer, but it harms the poor more than the wealthy because food—and the food tax—consume a larger portion of the poor family's food budget. Levied at the point of sale, the statewide food tax would bring in an estimated \$165 million in 1985-86, the fiscal year that begins July 1, 1985. The sales tax on non-prescription medicine would produce about \$20 million in revenues for the state next year.

Inventory Taxes: a local property tax, part of the system of ad valorem property taxes. Cities, counties, and certain special districts levy and collect all ad valorem taxes, which is their major revenue source for schools, water and sewer plants, fire and police protection, and other local services. The inventory

tax is not a separate category of taxation, and strictly speaking there is no such thing as an "inventory tax." Inventory taxes are simply part of the overall property tax system. To eliminate these local property taxes would require creation of a loophole specifically exempting from the property tax the inventories held by manufacturers, by wholesalers, and by retail merchants.

Since the early 1970s, certain types of manufacturers' inventories have been exempt from the tax. These include reductions in the rate of taxation for stored tobacco, peanuts, and baled cotton; and exemptions for merchandise held for export and for property in a foreign trade zone. In 1978, Gov. James B. Hunt Jr. pushed through another exemption for manufacturers aimed at enticing high-technology firms to the state.²

According to the Fiscal Research Division of the N.C. General Assembly, taxes applied to manufacturers' inventories in 1985-86 would bring in \$68 million for local governments; the tax on wholesalers' inventories would bring in \$28 million; and the tax on retail merchants' inventories would bring in \$59 million. If no change is made in the inventory tax, revenues for 1985-86 would total some \$155 million.

Intangibles Taxes: also a form of property taxes, applied to money and other instruments of wealth such as stocks and bonds. The N.C. Department of Revenue levies and collects this tax, deducts the cost of collections,

■ A proposed constitutional amendment by Rep. Josephus Mavretic (D-Edgecombe) and Rep. Martin Lancaster (D-Wayne) to allow individual counties to eliminate property taxes on business inventories.

■ A bill sponsored by Mavretic to repeal local sales and use taxes; to increase the *state* sales and use tax from 3 percent to 4.5 percent and to distribute the proceeds to local governments. This bill in effect would convert the present combination of state and local sales taxes to a statewide sales tax.

Other tax bills waiting when the legislature convened came courtesy of the Legislative Research Commission's study on revenue laws. These recommendations varied widely and wildly in scope—literally everything from the nuances of taxing slungshots versus slingshots to eliminating the sales tax on ice cubes.

Obviously, the buzzword of the 1985 session would be taxation—how to remove certain taxes, how to raise others, how to create new ones, possi-

bly even raising revenues through a state lottery (see article, page 24). Governor Martin assured that it would be so by becoming the first governor in the post-World War II era to make tax relief the linchpin of his legislative proposals. No recent gov-

“Taxes, after all, are the dues we pay for the privilege of membership in an organized society.”—Franklin Delano Roosevelt

ernor has proposed such sweeping *cuts* in the state's taxation system. These tax proposals, coupled with the Governor's supplemental budget package, gained for Martin the dubious distinction

and then distributes the revenue to local governments according to where the taxpayers live. This is considered among the most progressive of taxes because the burden falls most upon the wealthy—those who are more able to pay—even though the rate is the same for all.

The tax is levied on four major types of intangible personal property (see chart at right). Money on deposit (or in lock boxes or stuffed in a mattress) is taxed at the rate of 10 cents per \$100. Shares of stock, bonds, and other assets are taxed at the rate of 25 cents per \$100 of valuation. The chart below shows projected revenue estimates by the Fiscal Research Division for 1985-86, by type of intangible property (in millions of dollars):

Type of Property	Gross Collections	Net to Local Government
Money on deposit	\$19.4	\$17.9
Shares of stock	35.5	32.8
Bonds	12.5	11.6
Accounts receivable	10.5	9.7
Other	3.3	3.1
TOTAL	\$81.2 million	\$75.1 million

FOOTNOTES

¹Under state law, counties may levy a 1.5 cent sales tax. Governor Martin's proposals *do not* call for repeal of that local option tax.

²These measures were approved using the back-door “special provisions” approach, a practice to which the N.C. Center for Public Policy Research has long objected, as explained in *The 1983-85 North Carolina Budget: Finding the Missing Pieces in the Fiscal Jigsaw Puzzle*, 1984, pp. 17 and 61-62.

Governor Martin's Proposal

Type of tax relief (in millions of \$)	1985-86	1986-87	1987-88	1988-89
Eliminate 3% state sales tax on food and non-prescription drugs	\$70.3	\$178.1	\$189.6	\$203.1
Intangible tax reimbursement	—	3.0	88.7	96.0
Inventory tax credit/rebate	—	77.0	84.0	190.0
TOTAL (millions)	\$70.3	\$258.1	\$362.3	\$489.1

TOTAL over his administration: \$1.18 billion

(Figures supplied by Martin administration Office of Budget and Management and confirmed by Fiscal Research Division.)

of having one of the tardiest gubernatorial packages to be sent down from the Capitol to the Legislative Flats in the past two decades.

The dizzying array of tax proposals—from the Governor and Democrats alike—prompted Senate Finance Chairman Marshall Rauch (D-Gaston) to lay down the law early in the session. At his committee's organizational meeting, Rauch vowed to develop an omnibus tax bill that would include every tax-related measure that would be

Table 1: States with Inventory Tax and Intangibles Tax, 1985

The table below shows the states that levy taxes on business inventories and intangible personal property. Seven states—Georgia, Indiana, Kentucky, North Carolina, Ohio, Pennsylvania, and West Virginia—levy taxes on *both* business inventories *and* intangible personal property.

State	Inventory Tax ¹	Intangibles Tax ²
Alaska	X	
Arkansas	X	
Delaware	X	
Florida		X
Georgia	X	X
Hawaii	X	
Illinois	X	
Indiana ³	X	X
Iowa	X	
Kansas	X	
Kentucky	X	X
Louisiana	X	
Maryland	X	
Michigan		X
New York	X	
North Carolina	X	X
Ohio	X	X
Oklahoma	X	
Pennsylvania	X	X
South Carolina ³	X	
South Dakota	X	
Texas	X	
West Virginia	X	X

FOOTNOTES

¹Application of tax on retailing, warehousing and manufacturing inventories may vary broadly from state to state. Source: *State Tax Guide*, by Commerce Clearing House, Volume 1, 1985, p. 2022.

²Intangibles taxes levied by these states also vary in the rate and type of property assessed. Source: *State Tax Guide*, by Commerce Clearing House, Volume 2, 1985, pp. 662-663.

³Indiana and South Carolina are in process of phasing out taxes on business inventories. Indiana is also phasing out intangibles taxes.

Where Does North Carolina Stand?

Measurements of Tax Payments	North Carolina Ranking Among 50 States
Total tax burden with initial impact on business as a percentage of total state and local taxes	28
Taxes as a percentage of personal income	34
Total tax burden on hypothetical manufacturing corporation	42
Business taxes per non-agricultural private employee	44
Total taxes paid per capita	46

Source: Charles D. Liner of the Institute of Government, University of North Carolina. Various reports, Advisory Commission on Intergovernmental Relations.

sent to the Senate floor. Rauch's aim was to move the tax bill out early—meaning late May or early June—so that it could be debated *before* the general appropriations bill hit the Senate floor. To do otherwise would be to jeopardize chances of any substantive tax relief in 1985, said Rauch. "Historically, it is shown that [the] Appropriations [Committee] will spend all the money," he explained, locking in spending at a high level and leaving nothing to allow any tax cuts.

Legislators from both parties have indicated strong interest in cutting taxes significantly in the 1985 session. The only questions, as both parties jockeyed for position on the legislative track, seemed to be which taxes would be cut, and by how much. Of particular concern to those interested in taxation was what to do about the tax on wealth—the intangibles tax—and the tax on businesses—the inventory tax. To help focus the debate on those questions, *North Carolina Insight* presents a debate on each of those forms of taxation—as the N.C. General Assembly moves toward making major decisions on how much should be rendered unto Caesar. □

*"Vectigalia, nervos rei publicae."
(Revenues, the sinews
of the state)—Cicero*

**Table 2. Local Government Revenue Sources
Combined City and County Amounts, By County
Intangibles and Inventories Tax (in 1000s of dollars)**

	Estimated 85-86 Collections From Tax on Intangible Personal Property (Net)	Estimated Net 84-85 Collections From Property Tax on Business Inventories		Estimated 85-86 Collections From Tax on Intangible Personal Property (Net)	Estimated Net 84-85 Collections From Property Tax on Business Inventories
Alamance	1,406	3,407	Johnston	541	2,112
Alexander	144	403	Jones	49	22
Alleghany	85	59	Lee	477	1,170
Anson	198	507	Lenoir	727	888
Ashe	134	231	Lincoln	283	783
Avery	98	57	Macon	221	167
Beaufort	397	589	Madison	82	99
Bertie	136	147	Martin	212	725
Bladen	188	202	McDowell	216	590
Brunswick	362	366	Mecklenburg	9,661	18,627
Buncombe	2,662	DNR	Mitchell	110	259
Burke	769	1,713	Montgomery	156	356
Cabarrus	994	2,142	Moore	1,600	1,337
Caldwell	833	1,698	Nash	800	1,113
Camden	35	5	New Hanover	1,625	3,200
Carteret	600	348	Northampton	137	29
Caswell	110	44	Onslow	550	602
Catawba	1,791	3,272	Orange	1,465	629
Chatham	306	514	Pamlico	76	11
Cherokee	118	DNR	Pasquotank	336	344
Chowan	136	178	Pender	161	58
Clay	39	DNR	Perquimans	53	27
Cleveland	689	1,673	Person	184	332
Columbus	339	485	Pitt	972	1,852
Craven	603	1,058	Polk	651	20
Cumberland	1,616	2,074	Randolph	829	1,775
Currituck	71	17	Richmond	334	606
Dare	222	DNR	Robeson	674	1,495
Davidson	1,258	2,416	Rockingham	753	2,615
Davie	254	2,088	Rowan	1,217	1,946
Duplin	246	643	Rutherford	425	1,108
Durham	2,593	7,621	Sampson	312	574
Edgecombe	464	1,247	Scotland	284	836
Forsyth	5,406	11,254	Stanly	378	1,158
Franklin	203	310	Stokes	166	2,239
Gaston	2,037	4,171	Surry	656	1,429
Gates	43	22	Swain	60	39
Graham	55	81	Transylvania	349	487
Granville	272	938	Tyrrell	21	22
Greene	96	126	Union	591	1,429
Guilford	6,774	12,838	Vance	543	618
Halifax	471	591	Wake	5,200	7,828
Harnett	406	531	Warren	108	DNR
Haywood	374	665	Washington	95	388
Henderson	1,415	781	Watauga	395	321
Hertford	183	401	Wayne	822	1,709
Hoke	113	552	Wilkes	575	1,106
Hyde	33	8	Wilson	686	1,357
Iredell	874	2,136	Yadkin	178	243
Jackson	214	159	Yancey	115	25

Source: Ad Valorem Tax Division, N.C. Department of Revenue.

Key: DNR — Did Not Report.