

WINSTON-SALEM JOURNAL

Corporate income tax rate cuts could serve as logjam for state budget debate

Richard Craver - May 30, 2021



Newton

Independent Tribune

For much of the 21st century, North Carolina has been ranked among the nation's top states in most economic studies.

That's whether the state is surfing years long booms or surviving financial and housing bubble bursts.

Yet, state Senate Republicans continue to insist that for North Carolina to cement that lofty status, there's one key piece of legislation left to pass — getting rid of the corporate income tax.

The Republican legislative super-majority passed bills signed by then-Gov. Pat McCrory that reduced the rate from 6.9% in 2013 to 2.5% in 2019.

The 6.9% rate actually dates back to 2003, while the 2.5% rate is the lowest among the 44 states that have a corporate income tax.

With revamping House Bill 334 last week, GOP senators, led by Sen. Paul Newton of Cabarrus County, want to eliminate the corporate tax by 2028.

The bill is being fast-tracked to the Senate floor, being placed in the Senate Rules and Operations committee Thursday.

"The tax reforms that we have enacted over the past eight years have been critical to driving economic growth in our state and made us more competitive in attracting new businesses," Newton said.

Yet, Senate Democrats warn that ending the corporate income tax would cost North Carolina between \$500 million and \$600 million in annual tax revenue that could be used for education, infrastructure and public health initiatives.

Meanwhile, analysts caution the GOP legislators that achieving their goal could unleash socioeconomic and political ripples making the state even more purple at the statewide level.

All of which could make HB334 the 2021 butting-heads equivalent of Medicaid expansion that could overshadow this session's state budget discussions and lead to another veto-override tussle.

Gov. Roy Cooper spokesman Ford Porter said that "we have a once-in-a-generation opportunity to invest in our schools, quality child care, small businesses, community colleges, transportation, housing and tax cuts for families who really need it."

"The last thing we need is more sweeping tax breaks for corporations and the wealthiest among us instead of investments in our hard-working families and communities."

Soft pedaling

The Republican senators applied the gut-and-replacement strategy to H334 to insert the language that would cut the rate incrementally, starting at 2% in 2024 and dropping to 1.5% in 2025, 1% in 2026, 0.5% in 2027 and then to 0% in 2028.

In both HB334 and their joint statement, the senators took a minimalistic, oh-by-the-way, approach to the corporate income-tax cut proposal. The language pertaining to the rate cut was just 14 lines in the 41-page revamped bill.

"Over the past 10 years of Republican-led tax reductions, people and businesses have flocked to North Carolina in droves," they said. "There are many factors that weigh into a state's business climate, and tax structure is one of the top considerations."

Instead, the senators focused on sweeteners placed into HB334 designed to appeal to individual taxpayers.

"The measure is a continuation of the legislature's decade-long commitment to cutting taxes so people can keep more of the money they earn," according to the statement.

The state income tax would be lowered from 5.25% to 4.99%, while the state's child-tax deduction would rise by \$500 to up to \$3,000 annually for families who claim the federal child tax credit.

The personal income-tax deduction would be increased from \$21,500 to \$25,000 for a married couple, from \$16,125 to \$19,125 for a head of household, and from \$10,750 to \$12,750 for those who are single. Those changes would take effect Jan. 1.

HB334 also takes \$1 billion from the federal American Rescue Plan Act — which no member of the GOP congressional delegation voted for — to provide one-time jobs grants to businesses that could be worth up to \$250,000.

Qualifying businesses would have to demonstrate it "suffered substantial economic damage" from the pandemic "for which they were otherwise not fully compensated by providing economic support."

Newton said that "the Republican philosophy when government collects more money than it needs is to give it back through tax relief, and that's what we're doing here."

The opposition

Sen. Wiley Nickel, D-Wake, wasted little time criticizing the proposal to eliminate the corporate income tax.

"At a time when corporations are making record profits, and wealth and income inequality is at its highest, they hope to lower taxes on the wealthy and big corporations yet again," Nickel said.

"The Republican tax plan will continue North Carolina's race to the bottom when it comes to public education.

"One of the biggest reasons companies keep choosing North Carolina is our educated workforce, but this budget will put that in jeopardy.

Alexandra Sirota, director of the left-leaning N.C. Budget and Tax Center, said that "corporations are doing quite well in the pandemic, and state leaders are already asking them to contribute very little to our collective well-being."

"Asking them to provide no resources for the infrastructure and educational institutions in our state is bad policy and will hurt, not help, our efforts to build a strong economy."

Background

Interestingly, lowering — but not eliminating — the corporate income tax has had bipartisan support and appeal in this century.

For example, Democratic Gov. Mike Easley emphasized during his 2004 re-election campaign his support for a rate cut as the state and nation was enduring the final months of the 2001-03 recession.

According to an October 2003 report from The Associated Press, Easley said reducing the then-6.9% rate would help plug the flow of jobs out of North Carolina.

At that time, North Carolina's rate was the second highest in the Southeast, but down from 7.75% as recently as 1996.

AP reported in 2003 there was "nearly universal agreement among Republicans and Democrats in the General Assembly that the tax must come down if the state is to attract new corporations and jobs."

"The simple fact of life is that we need to be competitive with our neighboring states, who we compete with for new jobs," retired Wachovia Corp. chairman John Medlin was quoted in the article. "It's a terrible disadvantage."

Economic advantages

North Carolina has had significant success in luring corporate headquarters, manufacturing, research and development, and other operations — particularly from the Northeast.

North Carolina's recruiting pitch tends to consist of: a highly respected higher education system; multiple interstates cutting through the heart of its three major urban areas; central location along the East Coast; a skilled and trainable work force; and having the mountains and beach within a few hours' drive of most of its major population bases.

Which makes it challenging to evaluate and rank the importance of the corporate income tax rate and state economic incentives compared with those factors.

Bowman Gray IV, a local independent stockbroker and descendant of the R.J. Reynolds Tobacco Co. corporate executive tree, said there's little doubt North Carolina has been changed socioeconomically by bringing in such corporate headquarters, along major financial, pharmaceutical and technology sector operations.

In most instances, those corporate projects include the transferring in of tens of thousands of employees who tended to bring their socioeconomic and political viewpoints with them.

It's no coincidence that as Charlotte has grown to be the 15th largest city at more than 912,000 residents, and Raleigh 40th at more than 483,000 residents, both have become predominant Democratic strongholds in local and statewide elections.

"North Carolina's electorate has already begun to change between the Triangle, Charlotte and even the Triad with our major employers being in health care," Gray said.

"Bringing in more companies will only serve to accelerate what has already begun."

Mitch Kokai, senior policy analyst with libertarian think tank John Locke Foundation, recognizes the potential for the GOP senators' corporate income tax strategy to hamper their causes in future statewide elections.

"It is true that companies moving large number of employees from blue states into North Carolina could end up having an impact on the state's politics," Kokai said,

"It's the type of impact that's likely to interact with the decadeslong transformation of this state away from its rural base."

House vs. Senate

John Dinan, a political science professor at Wake Forest University, said the corporate income tax cut debate typically has been more between House and Senate Republicans in recent years than with the governor.

"There has been a longstanding dialogue between Republican senators and Republican House members over how far and quickly to reduce income-tax rates," Dinan said.

"Judging from prior years, there is likely to be a good amount of pushback from the House and a fair amount of give-and-take as they eventually agree on competing versions of the budget and tax plans in particular."

Michael Walden, an N.C. State University economics professor, said his research suggests that lowering both individual and corporate income-tax rates can lead to stronger job growth.

"A case can be made that recent tax policies in N.C. have helped the economy," Walden said.

"My personal and professional opinion is moving toward a tax system with a broad base and low rates is the best long-run tax policy to nudge faster economic growth."

Kokai questions how much of a deal-breaker eliminating the corporate income tax could be for the 2021 state budget.

Because the first reduction from the proposed rate wouldn't be effective until 2024, Kokai said "it's easy to picture this item becoming a bargaining chip, rather than an item that will make-or-break a budget deal."

Walden has warned that legislators can't be so focused on tax cuts to put off spending on pre-K-12 education initiatives "to ready youngsters for productive work careers."

"The evidence I see suggests lower class sizes, quality teachers and after-school programs for children living in challenging environments are all vital in improving the results of our primary and secondary education systems," Walden said.

Walden said that eliminating the corporate income tax "could stimulate additional growth in North Carolina."

However, Walden cautioned that growth "can bring disadvantages — more traffic congestion, higher housing prices and even changed voting patterns."

"There are costs and benefits to economic growth — and those costs and benefits are evaluated differently by different groups."

Thumbs up

Firmly on the side that a 0% corporate income tax rate would be beneficial to North Carolina is Tony Plath, a retired finance professor at UNC-Charlotte.

"It would be one more element in our long list of livability advantages over New York and New Jersey, and for all the Northeastern corporations already fed up and presently considering a relocation."

"It would provide one more reason to get off the fence and move here."

Plath said that a 0% corporate income tax "is quite consistent with our state branding and positioning messages, and it complements our list of business-friendly social and economic advantages quite nicely."

Plath believes new corporate relocations would offset the loss of \$500 million to \$600 million in corporate income-tax revenue.

"If a 0% corporate income tax rate provides the tipping point for even a modest number of high-quality corporate relocations out of the entire Northeast region, it will more than cover its cost in the number of new jobs and the personal tax revenue gains it creates," Plath said.

"At the same time, it keeps us competitive with other business-friendly Southern relocation destination states like Florida and Texas."

'If it's not broke'

Among those questioning why North Carolina needs to further lower or eliminate its corporate income tax is John H. Boyd, a national corporate site-selection expert based in New Jersey.

"If it's not broke, why fix it?" Boyd asked.

"North Carolina currently has the lowest corporate income tax rate in the nation and it is doing exceedingly well attracting new corporate investment and jobs to the state."

Boyd concedes that going to a 0% corporate income tax rate "would certainly be a talking point in terms of the state's marketing narrative."

"But, probably not enough to offset the lost revenues that would have to be made up elsewhere."

"Keep in mind North Carolina's 2.5% rate compares favorably with its chief regional competitors of South Carolina at 5%, Georgia at 5.75%, Virginia at 6% and Tennessee at 6.50%."

Interestingly, Republican legislative leaders have used the unemployment benefit programs from its neighbors to justify providing among the nation's lowest number of benefit weeks at 16 currently, but slated to drop to 13 on July 1.

Boyd suspects the state GOP senators have Texas in mind with their push for a 0% corporate income-tax rate.

"Texas does have a gross receipts tax, which most chief financial officers that we deal with consider to be more onerous than the corporate income tax," Boyd said.

The nonpartisan Tax Foundation also finds that gross receipts taxes on businesses "are generally thought to be more economically harmful due to tax pyramiding and non-transparency."

Boyd said that considering "the remote working trend will surely outlive the pandemic, the importance of a state's personal income tax rate has risen dramatically."

"North Carolina again shows well here at 5.25%, lower than South Carolina, Virginia and Georgia."