

An Analysis of North Carolina's Income Tax Changes from 2013 to 2014

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According to IRS and Census data, North Carolina gained about \$30 billion annually in adjusted gross income (AGI) from 1992 to 2014 due to residents moving in from other states.¹ The majority of North Carolina's new residents came from New York, followed by New Jersey, Virginia, Pennsylvania and California. During the same time period, however, North Carolina lost wealth from residents moving out of the state. Although North Carolina gained more wealth than it lost overall, its neighbors — South Carolina and Tennessee — were the top gainers from North Carolinians moving into their states. Could tax considerations be a factor in these relocations?



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In tax year 2013, North Carolina had state income tax rates ranging from 6 percent (on incomes of more than \$12,750) to 7.75 percent (beginning at \$60,000) with a \$1,150 personal exemption per individual. Later in 2013, however, Gov. Pat McCrory (R) and the General Assembly passed a significant tax reform package that included a reduction in the state income tax to a flat rate of 5.8 percent, effective January 1, 2014. How does the tax burden resulting from the new flat income tax rate compare to North Carolina's neighbors?

About the NCPA's State Tax Calculator. The NCPA's State Tax Calculator (www.whynotmove.org) is a tool to help people determine their tax burden by moving from one state to another. The State Tax Calculator is not a typical cost-of-living calculator. The software is based on a proprietary financial planning model developed by economist and Boston University Professor Laurence Kotlikoff.

The State Tax Calculator produces results based on the economic theory that households manage their finances so as to smooth out their discretionary spending over their lifetime. To make the calculator easy to use, there are also built-in assumptions about wages and investments:

- Wage/business income is the same in both states.
- Earnings during the working years will increase each year at the assumed rate of inflation of 3 percent.
- Any money invested in retirement accounts or regular savings accounts will grow at 4 percent per year.

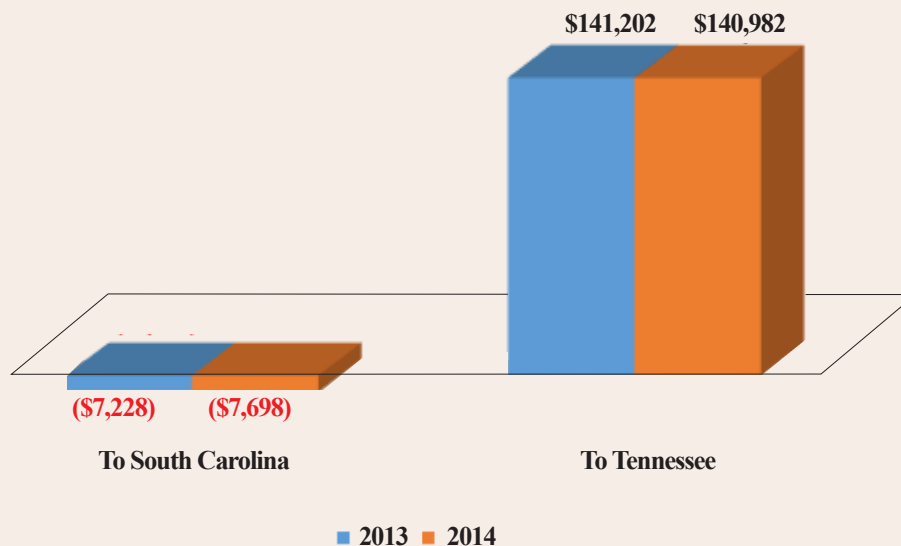
Additionally, annual and lifetime results are based on the assumption that the individual or couple live to be 100 years old, and that assets are spent down, leaving nothing to pass on to heirs.

The State Tax Calculator provides two results: the first is the annual discretionary income (income left after taxes, rent or mortgage payments) gained (or lost) each year as a result of moving from one state to another. The second result is the lifetime wealth gained (or lost) if the additional discretionary income had been invested each year at a 4 percent interest rate.

Moving from North Carolina to South Carolina. Over the past 22 years, the majority of personal income lost annually from North Carolina (about \$1.8 billion)

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Figure I
Change in Lifetime Wealth for 30-Year Old Single Renter
Moving from North Carolina



Source: Author's Calculations.

to other states went to South Carolina.² However, the two states' tax burdens do not differ substantially. For example [see Figure I]:

- In 2013, a 30-year old single renter earning \$75,000 a year lost only \$68 in discretionary income, for a loss in lifetime wealth of \$7,228, moving from North Carolina to South Carolina.
- In 2014 (after North Carolina's tax reform), the same single renter would have lost slightly more, only \$76 in discretionary income, for a loss in lifetime wealth of \$7,698.

Thus for a single, wage-earning renter, North Carolina's flat state income tax reduced the tax burden of the renter, but not by much. Consider the tax burden on older, married homeowners [see Figure II]:

- In 2013, a 40-year old married homeowner couple earning \$100,000 a year would have an additional \$420 in discretionary income annually by moving to South Carolina, for a lifetime wealth gain of \$36,219.
- In 2014, the same couple would have gained only \$392 in discretionary income, totaling \$32,385 in additional lifetime wealth.

Why does moving to South Carolina benefit the married

homeowners but not the single renter? There is a key difference in the situation of the homeowner and renter besides age and income. The homeowner pays property taxes, which are generally lower in South Carolina than in North Carolina. (The median property tax rate is 0.50 percent in South Carolina, compared to 0.78 percent in North Carolina.)³ State and local property taxes are deductible from federal income taxes, but do not reduce the taxpayer's burden dollar for dollar because the value of the deduction depends on an individual's income tax bracket.

Moving from North Carolina to Tennessee.

Tennessee ranks second for wealth gained from North Carolina residents. Tennessee does not have a state income tax,

so it may seem they have a large competitive advantage over their neighbors. Consider again the example of the 30-year old renter [see Figure I]:

- In 2013, a 30-year old single renter earning \$75,000 a year would have gained \$1,338 in discretionary income, for a lifetime wealth gain of \$141,202, by moving from North Carolina to Tennessee.
- In 2014, the same single renter would have gained slightly more, about \$1,389 in discretionary income annually, for a lifetime wealth gain of \$140,982.

The single renter in the previous example does much better moving to Tennessee than moving to South Carolina. But in light of North Carolina's tax reforms, the year to year differences do not change much, despite the fact that he is moving from an income-tax state to a no income-tax state. However [see Figure II]:

- In 2013, a 40-year old married homeowner couple earning \$100,000 a year would have an additional \$1,511 in discretionary income by moving to Tennessee, for a total lifetime wealth gain of \$130,401.
- In 2014, the same couple would have gained \$1,545 in discretionary income from moving to Tennessee, adding up to \$127,779 in lifetime wealth.

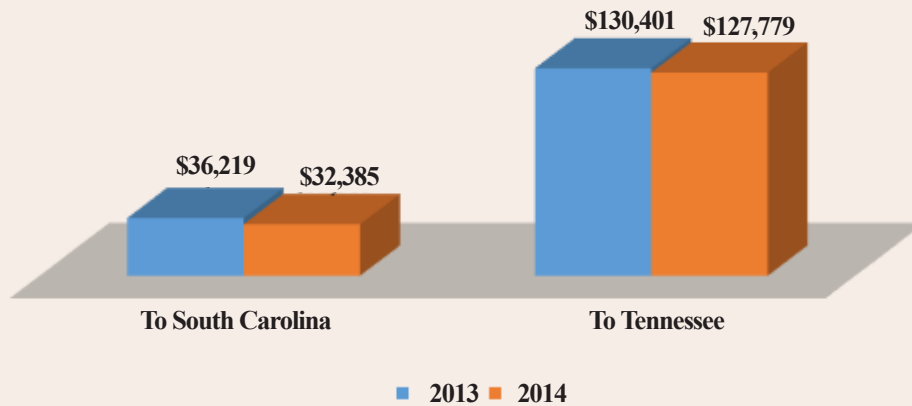
In the case of the married couple, the year to year differences are even smaller in dollar terms than for the single renter. Why is this? The calculator assumes money that is not saved or spent toward the purchase of a home is used for consumer purchases. It also assumes that about half of purchases are subject to state and local sales taxes. Tennessee ranks first in the nation for having the highest state and local average sales tax rates (9.45 percent in 2014 and 9.44 percent in 2013).⁴ Furthermore, Tennessee’s median property tax rate is 0.68 percent, which is lower than North Carolina’s but higher than South Carolina’s rate.⁵ Although the married couple is escaping the state income tax altogether by moving to Tennessee, they still face much

higher sales and property tax burdens, not explicitly faced by the renter. (It should be noted, however, that property taxes are implicit in rent payments — just not deductible from federal income taxes.)

Conclusion. North Carolina’s tax reform has made the state more competitive with its immediate neighbors. Indeed, in some cases, those living in South Carolina would fare better with a move to the North. But even in cases where South Carolina and Tennessee still have an advantage, the tax burden gap has become smaller.

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Figure II
Change in Lifetime Wealth for 40-Year Old Homeowner Couple Moving from North Carolina



Source: Author’s Calculations.

Notes

1. “IRS Tax Migration,” How Money Walks. Available at <http://www.howmoneywalks.com/irs-tax-migration>.
2. Ibid.
3. “Property Tax Rates by State,” Tax-Rates.org, available at <http://www.tax-rates.org/taxtables/property-tax-by-state>; and “How High Are Property Taxes in Your State?” Tax Foundation, available at <http://taxfoundation.org/blog/how-high-are-property-taxes-your-state>.
4. “How High Are Sales Taxes in Your State?” Tax Foundation. Available at <http://taxfoundation.org/article/state-and-local-sales-tax-rates-2015>.
5. “Property Tax Rates by State,” and “How High Are Property Taxes in Your State?”

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