

## 3. Where Does the Money Come From?

State government in North Carolina draws on several sources of revenue to pay for the services that the state provides. Think of a family. A family might have one parent with a full-time, nine-to-five job. Another parent might have a part-time job, or a small side business like delivering newspapers or selling cosmetics. The family also could generate income through an annual yard sale, investments like stocks and bonds, or by borrowing money.

Currently, the state receives about \$26 billion from many sources, including taxes, fees, and funds from the federal government. After taking out the federal dollars, which must be used for specified types of spending, and state taxes that are earmarked for specific items—like gas taxes that are earmarked for road maintenance, or monies set aside for the Clean Water Trust Fund—about \$14 billion remains to fund the state’s “discretionary” spending. This spending is usually what is meant when people refer to the “state budget” or General Fund.

### PERSONAL INCOME TAX

It receives most of the attention from lawmakers and the media because it can be spent on just about anything, from public schools to paper clips to elephant food at the state zoo.

For North Carolina’s state government, the personal income tax is like the family’s nine-to-five job. People who earn money in North Carolina pay anywhere from 6% to 8.25% of their income to the state. About 3.6 million individuals and couples file income tax returns in North Carolina each year. Income tax revenue is directly related to the economy—economic growth produces increased earnings, which generate increased tax revenues. On the other side of the coin, an economic downturn can create lower wages and lower capital gains, which can translate into sizeable drops in state tax collections. Personal income taxes account for *over half* of the state’s General Fund revenues.

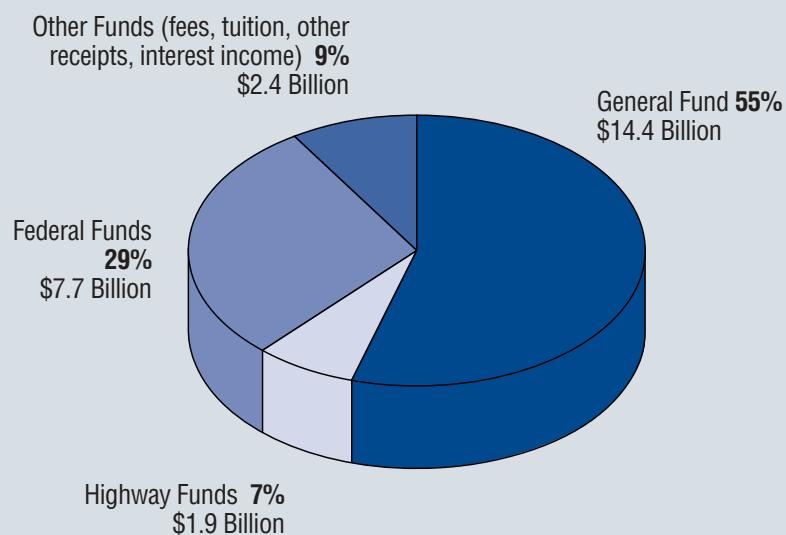
### GENERAL SALES TAX

The next largest source of revenue to the state is the 4.5% general sales tax. Consumers pay sales tax when they purchase goods (and a few services) in North Carolina. Sales tax revenue is a more stable source of income for the state than the income tax. Even when people are losing jobs, public assistance programs and personal debt allow people to continue spending money on goods.

Unfortunately for state and local governments, two recent economic shifts are eroding the strength of the sales tax as a source of revenue. The first is increased spending for services, which are virtually untaxed. As the economy grows, people have more money to spend on goods and services. Increased spending on goods brings the state increased sales tax collections, but increased spending on services does not. The second important shift is increased shopping through out-of-state catalogue vendors and on the Internet. If a book club decides to start ordering its books from

TOTAL BUDGET BY FUND SOURCE: FY2002–03

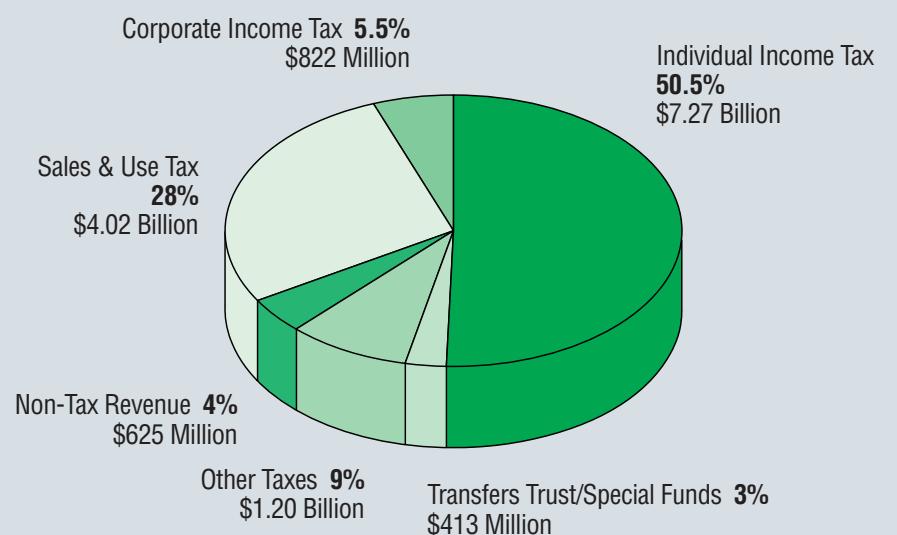
Total Budget: \$26.3 Billion



SOURCE: Fiscal Research Division, NC General Assembly

FIGURE 3.1

GENERAL FUND REVENUES BY FUND SOURCE: FY2002–03



SOURCE: Fiscal Research Division, NC General Assembly

FIGURE 3.2

### Quick Facts: Various Taxes

#### Income Tax

- An increase of  $\frac{1}{4}$  of 1% (0.25%) in all individual income tax rates is estimated to raise \$254 million in revenue each year

#### Sales Tax

- A 1% increase in sales tax is estimated to generate \$676 million in revenue in 2004–05

#### Excise Tax

- An increase in excise tax of 1¢ is estimated to raise between \$6–7 million

#### Corporate Income Tax

- A 1% increase in corporate income tax (from 6.9% to 7.9%) is estimated to raise \$107 million in revenue each year

Amazon.com instead of the local bookstore, the state loses revenue that it once received.

### CORPORATE INCOME TAX

A third source of income to North Carolina state government is a 6.9% tax on corporate income. This applies to all corporations which have business operations in our state. In the last fiscal year, corporate income taxes made up about 3% of General Fund revenues and about 6% of total state revenues. Some corporate income tax revenue is earmarked for a building fund for public schools. Revenue from this tax has been declining as a percentage of total collections for the last several decades, mostly due to increased taxes on individuals and changes in corporate structures designed to reduce corporate tax burdens. This source of revenue is particularly sensitive to swings in the economy—generally rising during the boom times and falling during recessions. (It's also important to keep in mind that smaller businesses like partnerships and limited liability companies pay personal income taxes, not corporate income tax.)

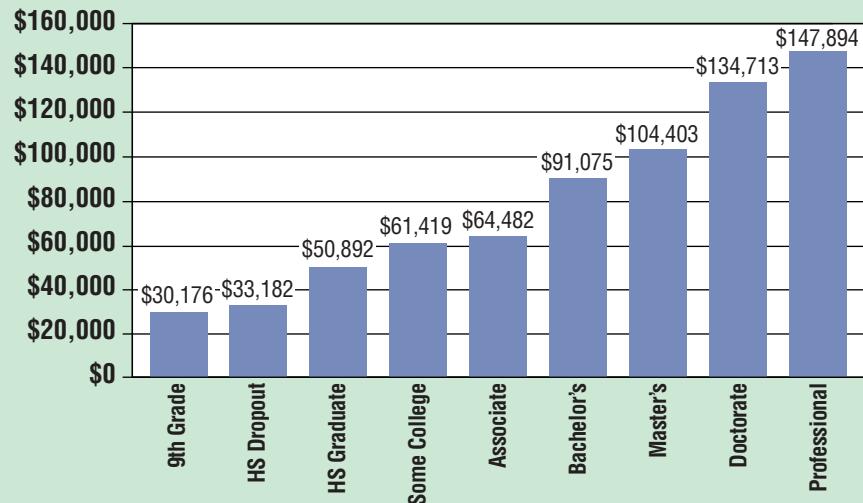
The state also imposes several smaller taxes, such as excise taxes on tobacco and alcohol products, franchise tax paid by certain businesses, estate tax, and a tax on insurance premiums. Even combined, these taxes make up only a small percentage of overall revenue to the state.

### NON-TAX REVENUE

The final way that the state raises money is called “non-tax” revenue. Non-tax income to the state includes fees or user charges such as court fees, community college and university tuition and hunting and fishing licenses. Governments charge fees for a variety of reasons. Some charges, like court fees, pay the administrative costs of providing a service. Others, like seat belt fines, are intended to discourage specific behavior. And some, like tuition charges, are intended to account for the private benefit derived from a government service. Other sources of non-tax revenue include things like investment income or transfers from other funds.

Such non-tax revenue makes up about 4.3% of the state's General Fund revenues. The remaining 95% is from state taxes.

### AVERAGE U.S. HEAD OF HOUSEHOLD INCOME BY EDUCATIONAL ATTAINMENT, 1999



SOURCE: Fiscal Research Division, NC General Assembly

FIGURE 3.3

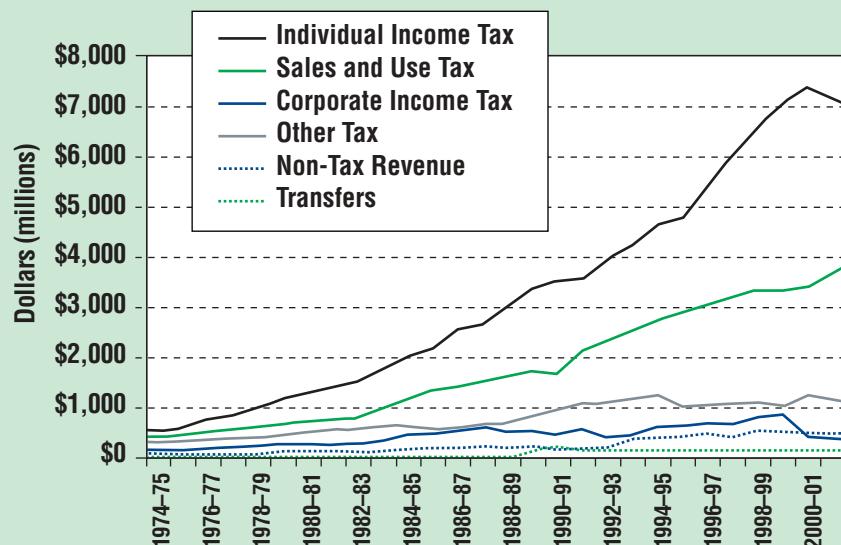
### SHARE OF GENERAL FUND REVENUES FROM CORPORATE INCOME TAX



SOURCE: Fiscal Research Division, NC General Assembly

FIGURE 3.4

### GENERAL FUND REVENUE



SOURCE: Fiscal Research Division, NC General Assembly

FIGURE 3.5