You Decide: Why are there new sales taxes?

By Dr. Mike Walden, North Carolina Cooperative Extension North Carolinians having repairs made to their vehicles are now in for a little bit of a shock. With a few exceptions, they will now have to pay state sales tax on the labor cost of those repairs. So, too, will folks paying for repairs to their computers and for installing modular homes. These are some of the new sales taxes that began March 1.

The most common reaction I've heard to the new taxes is, "What, there must be some kind of mistake!" Many people are aware of the state reducing taxes during recent years in an effort to make North Carolina more attractive for businesses and job growth. Doesn't putting sales taxes on vehicle repairs and other items go against this trend?

Let's see if I can explain what's happening and let you form your own conclusion. Several years ago North Carolina's public leaders embarked on a shift in how public revenues for the state are raised. An exchange would be made from income taxes to sales taxes. This was done in an effort to increase economic growth in the state. The logic was that if the state wanted businesses and households to create more income, then income should be taxed less.

The loss in income tax revenue would be partially made up by taxing consumer purchases (sales) more. But rather than increasing the sales tax rate, the "base" of the sales tax – that is, the kinds of purchases subject to the sales tax – would be broadened.

This meant adding some services to the state sales tax. Services had largely been untouched by the state sales tax since the tax's inception in the 1930s. Part of the reason was the service sector was largely non-existent then. But today, spending on services exceeds spending on tangible products. Indeed, some have argued it has been unfair in the modern economy for purchases of services to not be taxed but purchases of products to be taxed.

Before this year's changes, the state had made several additional purchases subject to the sales tax, including movie and other entertainment tickets. Also, the state component of the sales tax rate had been lowered a full percentage point. At the same time, the state income tax rates were lowered and standard deductions increased to reduce the effective tax on income.

So now that you know the reasoning, what have been the effects? Specifically, has the move from income taxes to sales taxes increased state economic growth, as intended? Also, are there any downsides to expanding the range of purchases subject to the sales tax?

As a professional economist for almost 40 years, I have to admit that answering the question about the effect of state taxes on economic growth is really tough. The state's economic performance has certainly improved in the last six years, so it's easy to automatically make a link between this result and the change in state taxes. But many researchers have concluded that bigger factors – like trends in the national economy and the industrial make-up of the state – have larger impacts than state taxes. I estimate that up to two-thirds of North Carolina's economic performance is linked to the national economy. So as the national economy has recovered in recent years, so has North Carolina's. Also, compared to the nation, twice as much of our state's economy is based on manufacturing. Since manufacturing tends to rebound faster from recessions than other sectors, North Carolina's strength in manufacturing has helped our economy grow since 2010.

Policy makers have long argued over the pluses and minuses associated with sales taxes. Some evidence suggests sales taxes provide a more stable source of tax revenue during the ups and downs of the economy. While incomes may plunge in recessions, people still need to spend to exist, so sales won't fall as much as income. However, new research shows this advantage of sales taxes may have disappeared during the Great Recession.

Yet on the minus side, sales taxes are claimed to be "regressive." This means, as a percent of a person's income, sales taxes take a larger bite for a lower income person than for a higher income person. It's usually the reverse for income taxes. For example, federal data show someone earning $15,000 annually pays – as a percent of their income – almost 50 percent more for vehicle repairs than a person earning $60,000. With the same sales tax rate applied to both, the person with lower income also pays – as a percent of their income – 50 percent more in sales taxes than the higher-income individual.

Now, it could still be the case that the lower-income person makes up for the extra sales taxes on vehicle repairs with lower state taxes on their income – including another reduction that will occur next year. Of course, this depends on a whole host of factors, including how much income is earned, age and number of dependents, and the kinds and sizes of tax credits and deductions the taxpayer can take.

There are two things always certain with changing taxes. They will create a variety of responses, and their impacts are different for different taxpayers. Based on your situation, you will have to decide if substituting sales taxes for income taxes is a net gain.

Dr. Mike Walden is a William Neal Reynolds Distinguished Professor and North Carolina Cooperative Extension economist in the Department of Agricultural and Resource Economics of North Carolina State University's College of Agriculture and Life Sciences. He teaches and writes on personal finance, economic outlook and public policy.

Cheraw Arts Commission Presents Porkchop Productions Show in April

Join a donkey, dog, cat & a rooster...four old animals in search of a rockin' new life in Bremen Town! Will they find musical stardom or will their plans of making it big be thwarted by bumbling robbers? Find out in this updated version of the timeless tale on Wednesday, April 20 at the Theatre on the Green when the Cheraw Arts Commission presents Porkchop Productions in the Bremen Town Musicians. There will be two shows at 9:15 a.m. and 10:30 a.m.

Porkchop Productions is a professional theatre company specializing in audience participation performances. Founded in 1991, the group performs throughout the southeast for schools, libraries, youth groups and special events. Admission is $4 per child with adults free. For additional information about the series contact the Cheraw Arts Commission at 843-537-8420 ext. 12.