

# ALERTS

## A (Somewhat) Brief History of Local Sales Taxes

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Though usually a sure-fire cure for insomnia for anyone other than a policy wonk or local government finance officer, local sales taxes have been a hot topic of debate recently in three high-profile news stories. In June, the Mecklenburg County Board of Commissioners voted to move forward with a referendum on increasing the local sales tax rate in the county from 2.5% to 2.75%. In August, the Wake County Board of Commissioners came to the opposite decision on whether to go forward with a similar referendum on increasing that county's local rate. Notably, both of these decisions were made in the shadow of legislation at the General Assembly that would have limited some counties' options with respect to local sales taxes while providing other counties with more flexibility.

Every county in North Carolina levies a local-option sales tax. The rate at which the tax is imposed varies based on a few factors. Currently, six counties in the State (Durham, Forsyth, Guilford, Mecklenburg, Orange, and Wake) have been authorized by the General Assembly to set the local sales tax rate as high as 2.75%. The remaining 94 counties are currently capped at a maximum rate of 2.5%.

However, very few counties have imposed the local sales tax at the maximum allowable rate. To date, only Durham and Orange Counties levy at the maximum rate authorized for them (2.75%). Mecklenburg County has the next highest local sales tax rate at 2.5%. As of October 1, 2014, 25 counties will levy local sales taxes at the rate of 2.25%. The remaining 72 counties all have local rates equal to 2%.

How this variation came about is a long story. In 1967, the General Assembly first authorized a county to levy a local sales tax - Mecklenburg County at the rate of 1%. The General Assembly attempted to extend this authority to all counties statewide in 1969, but ran into a few constitutional problems based on the process for imposing the local tax. In 1971, the General Assembly remedied those problems in a new act. Most counties quickly moved to levy the tax, but some waited several years before doing so. In 1983 and 1985, the General Assembly passed two additional acts, each allowing counties to levy an additional tax of 0.5%. Together, these acts form the basis of the first 2% of local sales taxes levied by all 100 counties in the State.

So far this is not too complicated, but things begin to get a little more confusing after that.

In 1997, the General Assembly enacted a local act that allowed Mecklenburg County to increase its local sales tax rate by an additional 0.5%. After a successful referendum authorizing the levy, the County took advantage of this authority and raised its local rate to the 2.5% that is in effect today. Notably, the proceeds of this tax can be used only for public transportation needs.

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In 2001, the General Assembly authorized all 100 counties to levy an additional local sales tax at a rate of 0.5%. Over the course of a few years, all counties did so. However, this authority was short-lived. In 2007, as part of a “swap” that relieved counties of the duty of funding a portion of Medicaid costs, the General Assembly repealed that authority and increased the State sales tax rate – keeping the overall rate constant but reconfiguring its State and local components.

At the same time the General Assembly voted in 2007 to repeal the existing authority for the last 0.5% increment of local sales tax, the General Assembly granted all 100 counties a new revenue option. Each county had the option of levying a land transfer tax at the rate of 0.4% or an additional sales tax at the rate of 0.25%. Since that time, 27 counties have voted to utilize this authority and to increase their local sales tax rates. (The local land transfer tax proved extremely unpopular. No county was ever able to impose the tax and the General Assembly repealed the authority of a county to do so in 2011.)

In 2009, the General Assembly voted to give counties another additional option for funding local needs. While the specifics are somewhat complicated, the 2009 legislation allowed each county other than Mecklenburg to further increase its local sales tax rate, but only to fund public transportation needs. The five counties at the cores of the Triangle and the Triad (Durham, Forsyth, Guilford, Orange, and Wake) could increase local sales taxes by 0.5% – putting them on par with Mecklenburg County, which had already been granted this authority in 1997 as discussed above. The remaining 94 counties could increase their local sales tax rates by 0.25%. To date, only Durham, Mecklenburg, and Orange have utilized this option to fund public transportation needs.

The recent controversy at the General Assembly had to do with this additional tax authorized for public transportation. H 1224, Local Sales Tax Options/Econ. Devpt. Changes, would have amended this authority. The general impact on counties of the final version of the legislation would have been as follows:

1. Durham and Orange Counties would not have been affected because of a grandfathering provision that would have maintained the status quo for counties that had already enacted local sales taxes at a rate above 2.5%.
2. Mecklenburg County would have been capped at a rate not to exceed 2.5% (less than the 2.75% currently authorized) unless a majority of the voters in the county approved an additional tax of 0.25% authorized under the 2007 legislation before the end of 2016.
3. Forsyth, Guilford, and Wake Counties would have been capped at a rate not to exceed 2.5% (less than the 2.75% currently authorized) unless a majority of the voters in the county approved an additional tax of 0.25% authorized under the 2007 legislation before the end of 2016, but these counties would have gained flexibility as to how proceeds of the taxes could be used.
4. The remaining 94 counties would have remained capped at a rate not to exceed 2.5% (the current maximum), but would have gained flexibility as to how proceeds of the taxes could be used.

Ultimately, H 1224 was not able to gain enough support during the final days of session to pass the House (it passed the Senate handily). Also included in the bill were numerous changes to the State’s economic development toolbox. The combination of local sales tax changes and economic development changes split House members into voting blocks not normally seen and not easily defined by party, ideology, or geography. Given the adjournment *sine die* of the General Assembly on August 20, the issue is dead for the current year.

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However, the issue is likely to be a hot one again in the 2015-16 General Assembly as another round of tax reform is expected.