

North Carolina Undertakes Tax Law Changes - Will There Be More?

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The North Carolina Legislature has approved a bill that rewrites the state tax laws, after many months of discussion and negotiation. The legislation, which Governor Pat McCrory signed into law on July 23, 2013, does not completely overhaul the tax code, but does make a number of changes that will impact business and individual taxpayers in North Carolina.

Many competing proposals were considered before arriving at the final tax plan, which represents a compromise between the House and Senate, while taking into account the viewpoint of the Governor. The proposals ranged from a complete overhaul of the tax code--including broadening the sales tax base for an additional 70 services and repealing many exemptions such as industry-specific tax credits and other special tax rates--to more modest approaches of lowering rates with a slight expansion of the sales tax base.

Below are some of the changes contained in H. 998 that may affect you or your company. The effective date of most provisions (unless otherwise indicated) is January 1, 2014.

Personal Income Tax

- Lowered from the current three-tiered structure, with rates ranging from 6% to 7.75%, to a flat 5.8% in 2014, lowered to 5.75% for 2015 and beyond.
- Personal exemptions are eliminated, as are deductions for retirement income, severance wages and the \$50,000 business income deduction.
- Taxpayers can take a standard deduction of \$15,000 for Married Filing Jointly (MFJ), \$12,000 for Heads of Household (HH), and \$7,500 for Married Filing Separately (MFS) or Single or the itemized deduction amount.

Charitable Contributions

- A point of contention throughout the process, leaders settled on allowing charitable contributions to be fully deductible, to the extent allowed for Federal tax purposes.

Mortgage Interest/Property Tax Deductions

- Capped at \$20,000.

Estate Tax

- Eliminated.

Corporate Income Tax

- Lowered from the current rate of 6.9% to 6% in 2014, 5% in 2015 and, if revenue targets are exceeded for either FY 2015 or FY 2016, the rate will be further lowered (to 4% in 2016 and 3% in 2017).

Business Franchise Tax

- No change (will remain at \$1.50 per \$1,000).

Expansion of Sales Tax Base

- There will be a new sales tax imposed on certain service contracts (namely, warranty, maintenance, and repair contracts).
- Provides for an exemption from the new sales tax if the underlying item for which the service contract is provided is tax-exempt.
- Implements a new sales tax on amusements and attractions for which admission is charged (with exemptions for certain school events, agricultural fairs and youth athletic contests).
- Repeals sales tax exemptions for nutritional supplements sold by chiropractors, meals sold in higher educational facilities, and newspapers (effective January 1, 2014) and eliminates sales tax holidays for school items and Energy Star products (effective July 1, 2014).

Electricity and Natural Gas Taxes (effective July 1, 2014)

- Taxes electricity at a combined general rate of 7% (currently taxed at 3% plus a 3% franchise tax).
- Taxes piped natural gas at a combined general rate of 7% (currently subject to an excise tax).

Nonprofits

- Nonprofit sales tax refunds are capped at \$45 million.

Motor Fuel Excise Tax

- Capped at 37.5 cents until June 30, 2015.

Studies

The Revenue Laws Study Committee is directed to study a number of issues during the interim, including:

- The feasibility of a preferential tax rate on diesel fuel sold to railroads, fuel sold to passenger air carriers, and fuel sold to motorsports.
- The authority of cities and counties to impose a privilege tax on businesses and the various State privilege license taxes.
- The impact of the elimination of the state and local sales and use tax refund on nonprofit entities and their ability to fulfill their stated mission.
- The benefits and fiscal impact of allowing corporations to deduct net operating losses as opposed to net economic losses.
- The feasibility of expanding the sales tax base to include additional services.

What's next?

As this year's debate demonstrates, tax reform is a multi-step process. Some of the items not tackled in this year's reform are being studied over the legislative interim, likely in preparation for further modifications to the tax code in coming years.

To learn more about the impacts of these tax code changes, or the studies and future legislative process, please contact a member of our government affairs team or tax counsel.

**Elizabeth Biser and Chris McClure are not licensed to practice law and they do not provide legal advice.*

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