

# Explanation of North Carolina's Tax Restructuring



Presentation to the Small Business Commission and the  
Manufacturing Development Commission

September 18, 2013

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# Objectives and End Result of Tax Restructuring



- ❧ The objectives/end result of tax restructuring in North Carolina:
  - Broadening of the corporate and individual income tax bases – repeal of most tax preferences;
  - Lower corporate and individual income tax rates;
  - Broadening of the retail sales tax base – expanding sales taxes to the services economy;
  - Reduction in overall individual income and corporate income taxes paid and an increase in overall retail sales taxes;
  - Repeal of the estate tax; and
  - Tax simplification.

# Fiscal Impact



☞ According to the North Carolina Fiscal Research Division, net revenue impact is (\$2.4) billion over the five-year period beginning with Fiscal Year 2014.

- Corporate income tax → (\$1.3) billion
- Individual income tax → (\$2.2) billion
- Retail sales tax → \$1.9 billion
- Estate tax → (\$0.3) billion

# Corporate Income Tax



- ❧ Rate is reduced from 6.9% to:
  - 6% for 2014 taxable year;
  - 5% for 2015 taxable year;
  - If FY 2015 General Fund revenues  $\geq$  \$20.2 billion, then 4% for taxable year 2016; and
  - If FY 2016 General Fund revenues  $\geq$  \$20.975 billion, then 4% or 3% for taxable year 2017.
  
- ❧ Corporate income tax rate beginning with taxable year 2017 is a maximum of 5% and a minimum of 3% percent.
  
- ❧ Many credits were eliminated or allowed to sunset: constructing renewable fuel facilities, biodiesel producers, interactive digital media, historic rehabilitation, low-income housing, conservation tillage tax credits, etc.
  
- ❧ Research and development tax credit was extended two years.

## Individual Income Tax



- ✧ Rate is reduced from 6%, 7%, and 7.75% to:
  - 5.8% for 2014 taxable year; and
  - 5.75% for 2015 taxable year and thereafter.
    - ▶ 5.75% is highest income tax bracket in Virginia.
    - ▶ 5.28% is average income tax paid in Virginia.
  
- ✧ Standard deduction is increased:
  - \$6,000 → \$15,000 for married filers; and
  - \$3,000 → \$7,500 for persons filing as an individual or married filing separately.

## Individual Income Tax



- ❧ Modified federal itemized deductions available to taxpayers not taking the standard deduction.
  - All charitable contribution deductions are allowed.
  - Up to a \$20,000 deduction is allowed for (mortgage interest + real estate taxes)
  
- ❧ No federal deductions are allowed for personal property taxes, unreimbursed medical costs, and employee expenses.
  
- ❧ For the most part, deduction for Social Security is only other deduction allowed.
  - Other retirement income deduction repealed.

## Individual Income Tax



- ❧ Other individual income tax changes include elimination of the personal exemption amount:
  - \$2,000 per person or \$2,500 if adjusted income  $\leq$  \$100,000.
- ❧ North Carolina 529 deduction eliminated.
- ❧ \$50,000 deduction for active small business income repealed.
  - Passed in 2011 and effective for taxable year 2012.
  - Repeal generates over \$400 million in revenue each year.
- ❧ Long-term care insurance, earned income tax, child care expenses, adoption related expenses, and education expenses credits eliminated.
  - Only the child tax credit was retained and increased from \$100 to \$125 per child if adjusted gross income  $\leq$  \$40,000.

## Retail Sales Tax



- ❧ No change in state and local rate of 6.75%.
- ❧ Sales tax expanded on January 1, 2014, to:
  - Live performances;
  - Movies;
  - Amusements for which admission is charged; and
  - Service contracts to maintain or repair property, but excluding labor.
- ❧ Exemption for newspapers and college meal plans repealed.
- ❧ Back-to-school and energy star sales tax holidays repealed.
- ❧ Increased tax rate on manufactured and modular homes to state rate of 4.75%.

## Other Changes



- ❧ Estate tax repealed effective for persons dying on or after 01/01/13.
- ❧ Gas tax capped at \$0.375/gallon through June 30, 2015.