

North Carolina Enacts Tax Bill with Changes to Corporate Income Tax Rate, Individual Income Tax Provisions and Sales and Use Tax

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Overview

On July 23, 2013, Governor Pat McCrory signed legislation, House Bill 998 (“H.B. 998”) in an effort to boost the state’s economy.¹ The bill, known as the Tax Simplification and Reduction Act, provides changes to the corporate income tax, individual income tax, and sales and use tax. In this Tax Alert, we summarize the more significant provisions of H.B. 998 including the relevant effective dates.

Corporate Income Tax Changes

Tax Rate²

For tax years beginning on or after January 1, 2014, NCGS §105-130.3 was amended to reduce the corporate income tax rate to 6%. The corporate income tax rate is further reduced to 5% for tax years beginning on or after January 1, 2015 through December 31, 2016. H.B. 998 also provides a rate reduction trigger such that if certain net revenue targets are met the tax rate will drop to 4% for tax years beginning on or after January 1, 2016 and to 3% for tax years beginning on or after January 1, 2017.

Tax Credits³

The expiration of the Research & Development tax credit, previously set for January 1, 2014, was delayed until January 1, 2016 by the amendment of NCGS §105-129.51(b). The absence of legislature action to extending certain other tax credit statutes, such as Article 3(J) credits for creating jobs and investing in business property, will allow these credits to expire pursuant to their respective existing sunset provisions.⁴

Individual Income Tax

Tax Rate and Exemptions

H.B. 998 amends NCGS §105-153.7 to eliminate the three-tiered personal income tax rate structure and imposes a flat rate of 5.8% for tax years beginning on or after January 1, 2014 and 5.75% for tax years beginning on or after January 1, 2015.⁵ The personal exemption provided by NCGS §105-134.6 has been eliminated.⁶

Deductions and Standard Deduction⁷

For tax years beginning on or after January 1, 2014, H.B. 998 amends NCGS §105-153.5 to provide an increased standard deduction as follows: \$15,000 for married taxpayers filing jointly, \$12,000 for head of household, and \$7,500 for single and married taxpayer filing separately. The legislation provides for an unlimited charitable contribution deduction by amending NCGS §105-153.5, but caps the aggregate deduction for mortgage interest and property taxes at \$20,000. The legislation also eliminates the \$4,000 deduction on

¹ *An Act to Simplify the North Carolina Tax Structure and to Reduce Individual and Business Tax Rates*, General Assembly of North Carolina, Session 2013, House Bill 998 available at:

<http://www.ncga.state.nc.us/Sessions/2013/Bills/House/HTML/H998v8.html>

² *Id.* at §§ 2.1.(a) – 2.2.(c).

³ *Id.* at § 2.3.(c).

⁴ These credits are repealed for business activities that occur on or after January 1, 2014.

⁵ *Id.* at §§ 1.1.(d) – 1.2.(b).

⁶ *Id.* at § 1.1.(b).

⁷ *Id.* at § 1.1.(d).

government retirement income, the \$2,000 deduction on private retirement income, and the \$50,000 business income deduction.⁸

*Estate Tax*⁹

The estate tax has been repealed effective January 1, 2013 through the repeal of Article 1A of Chapter 105 of the NC General Statutes.

Sales & Use Tax Changes

*Electricity and Piped Natural Gas*¹⁰

Effective July 1, 2014, H.B. 998 repeals the current reduced sales tax rates in effect for electricity under NCGS §105-164.4(a)(1f) and (a)(4a) and the current exemption for piped natural gas under NCGS §105-164.13(44). As a result, NCGS §105-164.4(a) is amended to subject electricity and piped natural gas to the sales tax at the combined general rate, which is currently 7% statewide, regardless of county. With respect to the sale of electricity, the current exemptions for farmers, eligible internet data centers and manufacturers will continue to apply.

To balance the increase in the sales tax rate on these items, H.B. 998 repeals NCGS §105-116, NCGS §105-116.1, NCGS §105-164.21A and NCGS §159B-27(b), (c), (d) and (e) regarding the imposition and administration of the gross receipts franchise tax currently imposed on electric power companies and providers of piped natural gas.

*Service Contracts*¹¹

H.B. 998 amends NCGS §105-164.4(a) by imposing sales tax on service contracts defined under NCGS §105-164.3. A “service contract” is defined as a warranty agreement, a maintenance agreement, a repair contract, or a similar agreement or contract by which the seller agrees to maintain or repair tangible personal property. However, NCGS §105-164.13 is amended to provide an exemption for service contracts for tangible personal property exempt from sales and use tax (except motor vehicles) and for network assets contained on utility-owned land, right-of-way, or easements. NCGS §105-164.13 also provides an additional exemption for items used to maintain or repair tangible personal property pursuant to a service contract if the purchaser of the contract is not charged for the item. These changes are effective for sales or purchases made on or after January 1, 2014.

*Amusements and Entertainment*¹²

Effective January 1, 2014, H.B. 998 amends NCGS §105-164.4 to include a detailed listing of “admission charges” subject to the general rate of sales tax. Most admission charges, including movies, live entertainment, and museums/exhibits, will be now be taxable with only five exemptions enumerated.

To offset the imposition of sales tax on these admission charges, H.B. 998 repeals the gross receipts privilege tax levied on providers of admission to live entertainment and motion pictures under NCGS §105-37.1 and NCGS §105-38.1.

*Imposition of Cap on Nonprofit Refunds*¹³

Under NCGS §105-164.14(b), certain qualified nonprofit entities are allowed a semiannual refund of state sales and use taxes paid on certain items for use in carrying on the work of the nonprofit entity with no cap. H.B. 998 amends this section to cap a nonprofit entity’s fiscal year refund of the state tax portion at \$31,700,000 and the local tax portion at \$13,300,000. The state and local amendments, totaling a \$45,000,000 combined state and local tax refund cap, are effective July 1, 2014.

⁸ *Id.* at § 1.1.(b).

⁹ *Id.* at § 7.(a).

¹⁰ *Id.* at §§ 4.1.(a) – 4.1.(f).

¹¹ *Id.* at §§ 6.(a) – 6.(c).

¹² *Id.* at §§ 5.(a) – 5.(c).

¹³ *Id.* at §§ 3.4.(b) – 3.4.(c).

Sunset Extension for Passenger Air Carrier and Motorsports Team Exemptions¹⁴

H.B. 998 extends for two years the sunset date for the annual sales and use tax refund provisions for purchases of fuel by passenger air carriers in excess of \$2,500,000, as well as aviation fuel and 50% of certain other tangible personal property purchased by motorsports teams, from January 1, 2014 to January 1, 2016.

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¹⁴ *Id.* at § 3.5.(a).