

2019 NORTH CAROLINA LEGISLATIVE UPDATE CLE

1. INTRODUCTION

- a. Layout
 - i. Begin with a review of the current state of our electoral politics, take a look at the 2019 long-session, and take an in-depth look at corporate tax policy.

2. LEGISLATIVE PROCESS

- a. North Carolina System
 - i. 2-Year Schedule
 - 1. In odd numbered years we have a “long session.” In even numbered years we have a “short session.” Over the past-year, we have been in the long session.
 - 2. Long session – everything is up for grabs but the top priority is the 2-year budget, which never passed.
 - 3. Short session – only things that passed one chamber in the long-session or finance/budget related matters may be considered.
 - b. Where does the power lie in North Carolina?
 - i. According to the NC Constitution, the legislature has the bulk of the power delegated to elected officials.
 - ii. For example, the state budget is most certainly the largest wielding of power in state government.

3. 2018 MIDTERM ELECTION

- a. What happened?
 - i. US House
 - 1. Democrats gained 41 seats to flip the control of the US House.
 - 2. Highest turnout for a midterm election in more than a century.
 - 3. In NC, the 9th and 13th districts were considered toss-ups. In the 13th, Rep. Ted Budd (R) defeated Kathy Manning (D). In the 9th, Mark Harris (R) *defeated* Dan McCready (D). This race was overturned by the NC State Board of Elections and a special election was held in September that was won by Republican Dan Bishop.
 - ii. US Senate
 - 1. Republicans gained 2 seats in the US Senate.
 - iii. NC House
 - 1. Legislative districts used in 2016 were changed in 2017 by a court order that resulted in 19 districts being changed by a court appointed special master.
 - 2. Democrats picked up 10 seats in the NC House – moving the majority from 75-45 to 65-55. Most importantly, Democrats broke the GOP “Supermajority.”
 - 3. 26 out of 120 members were freshmen – including 9 Republicans and 17 Democrats.

4. Of the Democrats, 10 were from Wake and Mecklenburg Counties.
- iv. NC Senate
1. Legislative districts used in 2016 were changed in 2017 by a court order that resulted in 9 districts being changed by a court appointed special master.
 2. Democrats picked up 6 seats in the NC Senate – moving the majority from 35-15 to 29-21.
 3. 13 out of 50 members are freshmen – including 6 Republicans and 7 Democrats.
 4. Of the freshmen Democrats, they serve New Hanover, Wake, Cumberland, Guilford, and Mecklenburg counties. Of the freshmen Republicans, they serve Chowan, Harnett, Rowan, Davidson, Union, and Cleveland counties.

4. IN DEPTH LOOK AT NORTH CAROLINA TAX POLICY

- a. History of Tax Reform:
 - i. Explanation of tax system prior to 2014
 1. Personal Income
 - a. Graduated rate from 6 – 7.75%
 - b. Smaller Standard Deduction, personal exemptions for dependents
 2. Corporate Income
 - a. Fixed rate at 6.9%
 - b. Numerous credits including solar production/development, mill rehabilitation, cigarette export, etc.
 - c. Apportionment methodology that penalized NC job creation. Valuation of property and payroll for manufacturers was included, boosted % of income taxable in NC.
 3. Sales Tax
 - a. Tax rate was increased on a number of occasions topping out at a statewide rate of 5.75% thru 2011 when the authorizing legislation expired and reduced the rate to 4.75%.
 4. Franchise
 - a. Rate of \$1.50 per \$1,000 of value. Certain minimum payments were included. Same as current rate. Franchise tax is not a tax on McDonald Franchisees. It is an assessment on the overall value of the a corporation, and the most expensive calculation: Net value vs property valuation vs tangible property investments.

5. MAJOR TRANSITIONS FROM 2013-2018

- a. Overall Income Tax Rate Reductions
 - i. Personal – Flat rate established for TY 2014 at 5.8%, TY 2015 & 2016 at 5.75%, 2017 & 2018 at 5.499% with an additional .1% withholding, and

TY 2019 at 5.25% which is the lowest in the Southeast for a state with an income tax.

- ii. Repealed NC Estate Tax
- b. Increase in Standard Deduction & Elimination of Exemptions
 - i. Personal exemptions were eliminated,
 - ii. Standard deduction was increased from \$3,000 for single filers & \$6,000 for married filing jointly to \$7,500 for single and \$15,000 MFJ. Standard Deduction was slowly increased to \$20,000 for married filing jointly in legislation in 2017 taking effect in 2019 tax year.
 - iii. Mortgage interest and property tax deduction is capped at \$20,000.
- c. Simplification of apportionment strategies – Manufacturing
 - i. Corporate tax filers, who were manufacturers use single sales factor apportionment. Calculate North Carolina taxable revenue by dividing sales in NC by sales everywhere. Major simplification of corporate tax apportionment, reduces fraud, and reduces incentive for tax planning.
 - ii. Why is Single sales factor important?
- d. Elimination of credits for host of industries
 - i. Phase out of all but two tax credits – Historic Rehabilitation Tax Credit and Railroad Intermodal Facility
 - ii. Renewable energy property, constructing renewable fuel facility, biodiesel producers, work opportunity, donating funds for purchases of renewable energy property, research and development, interactive digital media, creating jobs, investing in business property, investing in real property, mill rehabilitation, NC state ports authority charges, cigarette exportation, Film & Entertainment are gone
- e. Simplification of Franchise Tax Calculation allowing use of GAAP Rules
 - i. Requires Partnerships that file as corporations to pay franchise tax.
- f. Expansion of Sales Tax Base
 - i. 2013/14 legislation passed that authorized sales tax on entertainment activities and began the expansion into real property services and service contracts.
 - ii. In 2015 General Assembly authorized the expansion of sales tax to Repair, Maintenance, and Installation services for real and tangible property.
 - iii. Capital improvements were generally exempted. The NC DOR has continued to refine the logic of taxable services and they regularly update a taxability matrix available on their website:
<https://www.ncdor.gov/taxes-forms/sales-and-use-tax/repair-maintenance-and-installation-services-and-other-repair-information>
- g. Interest Expense Deduction
 - i. NC allowed full interest expense deductions until 2015 when the deduction was capped at 30% of interest.
 - ii. Change in 2016 allowing a 100% deduction if corporations could prove that the interest expenses were to service outside debt.
- h. Mill Machinery Sales Tax Exemption

- i. 2017 Legislation authorized mill machinery, special manufacturing equipment to be fully exempt from state sales tax. This equipment had previously been subject to a 1% tax with a maximum of \$80.
 - ii. This tax was very detrimental to smaller manufacturers who purchased many smaller pieces of equipment.
- i. Decision points on Federal Tax Cuts and Jobs Act (TCJA)
 - i. North Carolina opted to exclude foreign derived income from NC taxable income
 - ii. North Carolina did not adopt the tax benefits for investments in opportunity zones
 - iii. NC conformed to the rules for limitation on the deduction for business expenses IRC 163(j)

6. MAJOR LEGISLATION IN NORTH CAROLINA IN 2019

- a. Internal Revenue Code Annual Update
 - i. Senate Bill 56; Session Law 2019-6
 - ii. Title: Technical Changes to the Revenue Laws
 - iii. Updates the conforming date for the NC General statutes to January 2019
 - iv. Cleans up prior mistakes, incorrect cross references, and updates terminology to conform with modern business practices.
 - v. Section 5 – Sets forth statute on “Wayfair” decision in which businesses conducting retail sales have sales tax nexus with NC if they have gross sales of \$100,000 or more than 200 separate transactions. Substantial revenue opportunity and targeted very specifically at online retail giants.
- b. Agency clarifying and administrative changes
 - i. SB 523: Session Law 2019-169
 - ii. Signed into law July 26, 2019
 - iii. Opening 26 pages are all ticky-tacky sales tax changes.
 - iv. Next 10 are excise tax changes.
- c. Trends away from standalone legislation
- d. Trends toward bundled legislation
 - i. Major legislative issues were not originally passed by either the house or senate because they have been increasingly included only in the budget.
 - ii. This trend was bucked in 2019 because of the budget impasse.
 - iii. Legislative leaders have paired popular tax measures with slightly less popular proposals to help drive messaging goals.
 - iv. SB 557 – Ratified on November 1, 2019
 - 1. Increases standard deduction from \$20,000 to \$21,500 for MFJ
 - 2. Sets the stage for Market Based Sourcing for the apportionment of taxable revenue for corporations providing services. Sales of services to NC Customers divided by services sold everywhere. This gets extremely complicated and has been broken down to address services broadly, for financial institutions, and television/video content distribution.

3. Requires online sales facilitators to collect and remit sales tax for NC if sales are greater than \$100,000 or there are more than 200 transactions annually.
- v. SB 578 – Ratified on November 1, 2019
 1. Simplifies how to calculate franchise tax; Business only assessed on net value based on GAAP rules.
 2. Reduces franchise tax rate to \$1.29 per \$1,000 of value for corporations in tax year 2021.
 3. Reduces franchise tax rate to \$0.96 per \$1,000 of value for corporations beginning 2022.

7. MAJOR TAX POLICY GOALS INCLUDED IN BUDGET

- a. Increase standard deduction from \$20,000 to \$21,000 for tax year 2020.
- b. Rate reduction of franchise tax to \$1.29 in tax years 2021 and then \$0.96 in 2022.
- c. Implement Market Based Sourcing – broad rules, broadcaster/television content, petroleum products, and banking/financial services.
- d. Marketplace facilitators that requires them to collect and remit sales tax.
- e. Sales tax law, Repair, Maintenance, and Installation, clean up. Exemption for real property management.
- f. Extend Historic Rehabilitation tax credit for 4 years.
- g. Extend aviation jet fuel sales tax exemption extended to Jan 1, 2024.
- h. Extend sales tax exemption for motorsports teams.
- i. Allows for short term workforce/businesses in post-disaster recovery services to be exempt from payroll tax and certain registration requirements.