Overview of North Carolina’s Corporate Income Tax

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April 7, 2010
Business Taxes in North Carolina

- Corporate Income Tax
- Franchise Tax
- Annual Reporting Fees
- Privilege and License Taxes
- Excise Tax on Certain Machinery & Equipment
- Sales Tax
- Property Tax
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Evolution of NC’s Tax System

1777

2nd act of General Assembly

Created Tax System
Evolution of NC’s Tax System

License taxes first enacted 1782
Evolution of NC’s Tax System

1849

Corporations taxed on capital stock – forerunner of franchise tax

Free public schools in 1839
Evolution of NC’s Tax System

Revenue Act of 1921

- No State tax on property
- Two new taxes:
  - State administered PIT
  - Corporate IT

1921
NC Corporate Income Tax Rates

- 1921: 3% of net income
- 1939: 6% of net income
- 1987: 7% of net income
  - Public School Building Fund
- 1991: 7.75% of net income, plus surtax
- 1996: phased down rate to 6.9%, effective after 1999
- 2009: 3% surtax for 2009 and 2010
Corporate Tax Rates
Corporate Income Tax Decline

- Since 1950s, the federal corporate income tax has been declining as a percentage of government revenues
- NC corporate income tax base has been following the same trend
Reasons for Decline of CIT

- **Tax Policy Decisions**
  - Federal tax policy decisions
  - NC tax policy decisions
  - State tax credits

- **Tax Shifting Strategies**
  - Made possible to a large degree by single entity reporting
Basic CIT Building Blocks

- Tax rate applied to net taxable income
  - All corporations chartered in NC
  - All corporations doing business in NC
- Tax credits applied
Taxable Income

- NC taxable income = Federal taxable income, as adjusted
  - Accelerated depreciation
- Key differences
  - Net operating loss v Net economic loss
  - Bonus depreciation
- State deduction adjustments
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Tax Policy Decisions that Reduce CIT Collections
State Tax Credits

- Dwelling units for handicapped
- Real property donations
- Conservation tillage equipment
- Gleaned crop
- Manufacturing cigarettes
- State ports
- Renewable energy
- Film production
- Small business health insurance
- WOTC
- Rehabilitation
- Low income housing
- R&D
- Article 3J
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Tax Policy Decisions that Reduce CIT Collections $164.5 million for FY 09-10
Apportionment Formula

- Multistate corporations apply NC apportionment formula to determine NC taxable income
- Apportionment formulas
  - Three factors: Sales, Property, and Payroll
  - Double-weighted sales (1988)
  - Single sales (2009 for a ‘qualified capital intensive corporation’)
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Business & Non-Business Income

Multi-state corporation required to:

- Allocate its non-business income to a state based on its connection with that state
- Apportion its business income between the states in which it conducts business based upon each state’s apportionment formula
Business & Non-Business Income

- State law defines ‘business income’
- **Strategy**: Characterize income as non-business income
- Pre-2002, NC definition narrow
- 2002, NC changed its definition of business income to include all income that is apportionable under the US Constitution
Single Entity Reporting

State filing options

- Mandatory separate entity returns
- Elective consolidated returns
- Mandatory combined unitary returns
- Discretionary combined unitary returns
- A hybrid system
  - Require single entity reporting
  - Unless directed otherwise by Secretary of DOR
Single Entity Reporting

- NC requires a separate return
- Must determine State net income as if a separate return had been filed for federal tax purposes

**Strategy:** Create legal structures to shift income from one state to another, lower tax, state
- IHC
- *Limited* case
Single Entity Reporting

Legislative efforts to address income shifting

- 2001: Royalty add-back
- 2002: Broad definition of business income
- 2005: Consideration of “throwout” rule
- 2006: Patent and copyright add-back
- 2007: Captive REITs
Single Entity Reporting

- “Forced combinations” by Secretary of DOR
  - Uncertainty as to when to combine
  - Uncertainty as to who is included in the combination
- *Walmart v. Hinton* upheld Secretary’s authority to require combined reporting
- Millions collected through forced combinations – RECENT PROJECT
Tax Reform Options

- Mandatory combined reporting
  - Comprehensive way to nullify tax shifting strategies
  - Broadens the corporate tax base
  - Reduces uncertainty re: combinations

- Reduce tax credits and deductions
- Reduce corporate tax rate
- Equal weighted apportionment formula, with throw-out or throw-back rule