

Overview of North Carolina's Franchise Tax

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April 7, 2010



History of Tax

- One of NC's oldest taxes
- Originated in 1849 as a tax on the capital stock of a corporation
- 1901- 1913, rate was graduated and ranged from \$5 to \$500.
- 1913 – rate set at percentage (.001)
- 1933- rate set at \$1.50 per \$1,000 (.0015)



Nature of Tax

- Privilege tax for:
 - Privilege of engaging in business
 - The “enjoyment, under the protection of the laws of this State, of the powers, rights, privileges and immunities derived from the State by the form of” the existence of the business structure
 - The benefit and protection received from the government and laws of NC in doing business
 - Privileges not possessed by individuals or partnerships



Businesses Subject to the Tax

- C corporation
- S corporation
- Electric membership corporation
- Limited liability company (LLC) that elects to be taxed as a corporation under the IRC



Businesses Not Subject to the Tax

- Limited liability company (other than ones electing to be taxed as a corporation)
- Limited liability partnership
- Limited partnership
- Partnership
- Sole proprietor
- Insurance companies



Rate of Tax

- \$1.50 per \$1,000 of taxable assets (.0015)
- \$35 minimum tax
- \$75,000 maximum tax for holding companies – those that receive at least 80% of income from subsidiaries



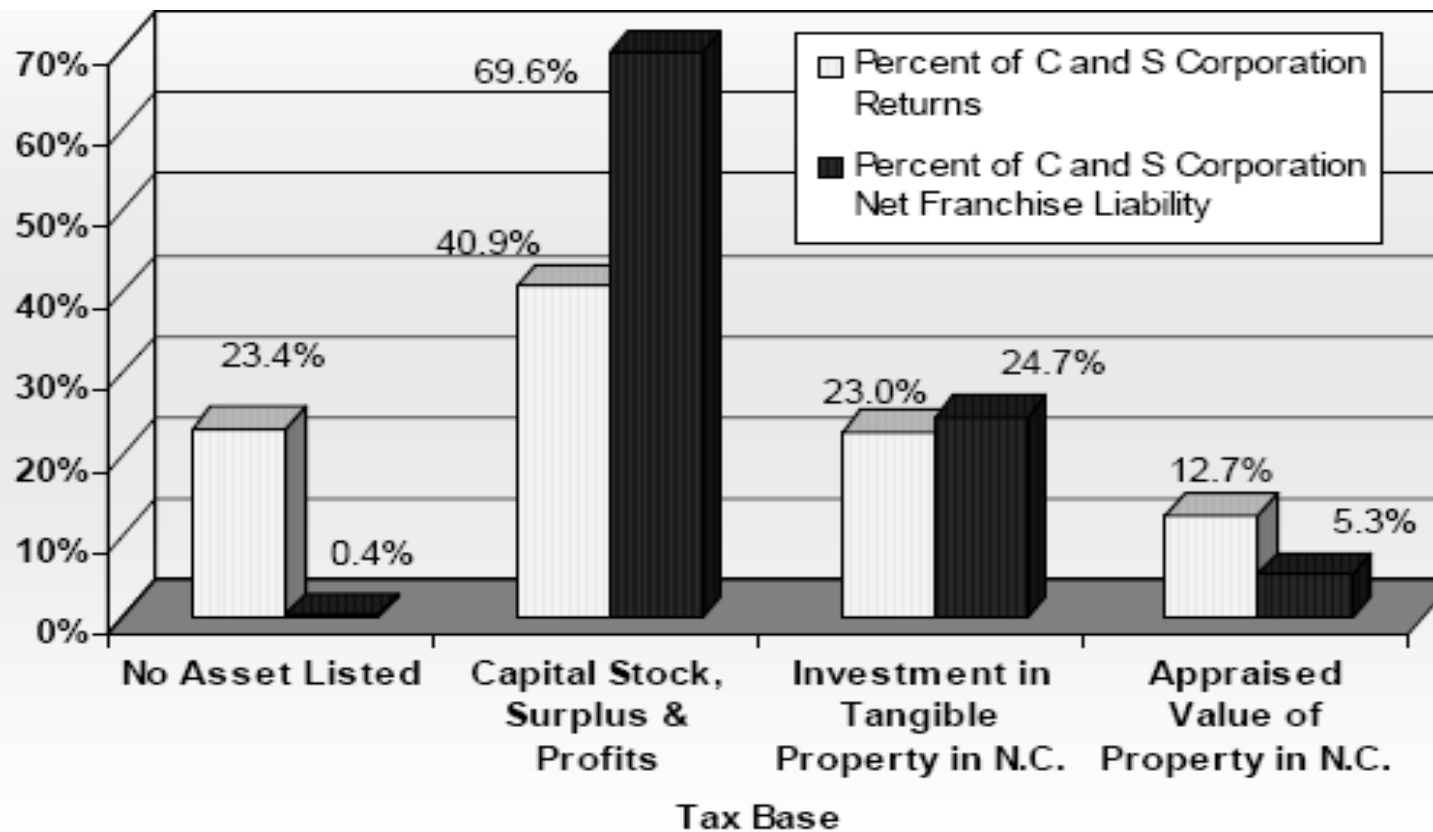
Calculation of Tax

Tax rate applied to highest of three asset bases:

- Capital stock, surplus, and undivided profits apportioned to NC using the apportionment percentage determined for income tax
- Book value of NC real and tangible personal property, less outstanding debt created to acquire or improve the real property
- 55% of the appraised value of NC real and tangible personal property



Franchise Filers By Base



Utility Franchise Tax

- Applies instead of the general franchise tax
- Calculated on gross receipts
- Applies to:
 - Electric power company – 3.22% rate
 - Water utility company - 4% rate
 - Sewer utility company – 6%
- Tax on electric power companies is shared with cities



Other States

State	Franchise Tax
NC	Yes: .0015 of asset base
FLA	No
GA	Yes: ranges from \$10 to \$5,000
KY	Yes: .0021 of capital employed
SC	Yes
TENN	Yes: .0025 of asset base



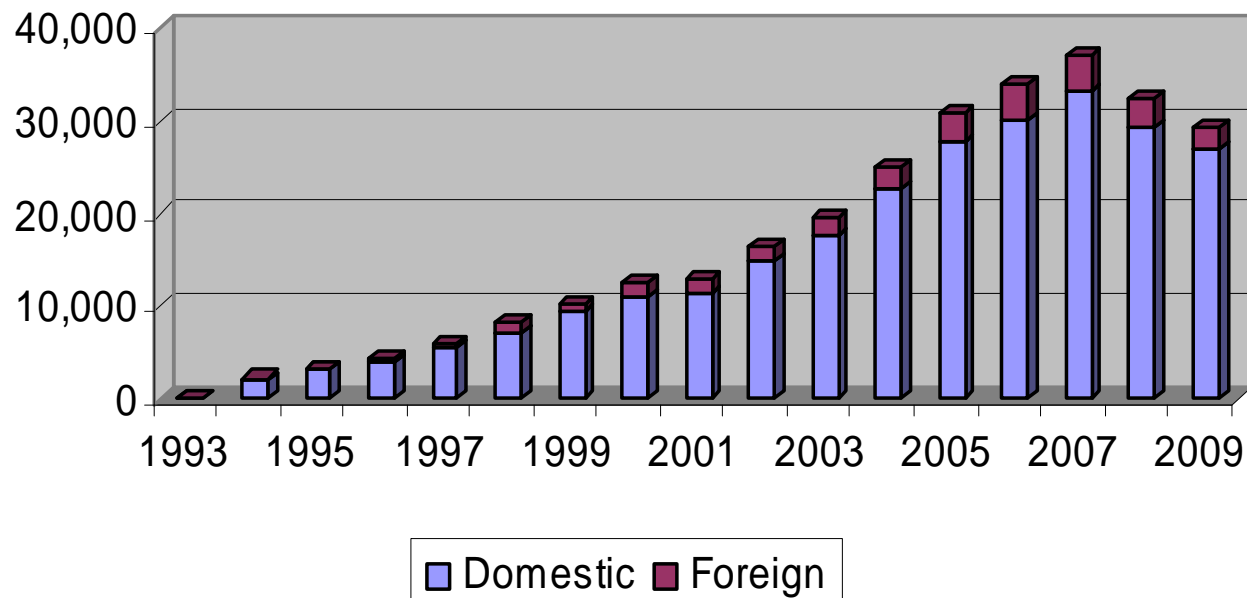
Limited Liability Companies in NC

1989	LLCs authorized; higher annual report fee imposed on LLCs in recognition of their exclusion from franchise tax
1997	Single member LLCs authorized
2001	Corp required to include assets of controlled LLC
2002	Controlled LLC requirement tweaked
2006	LLC subject to franchise tax if it elects to be taxed as C corp
2009	LLC subject to franchise tax if it elects to be taxed as S corp

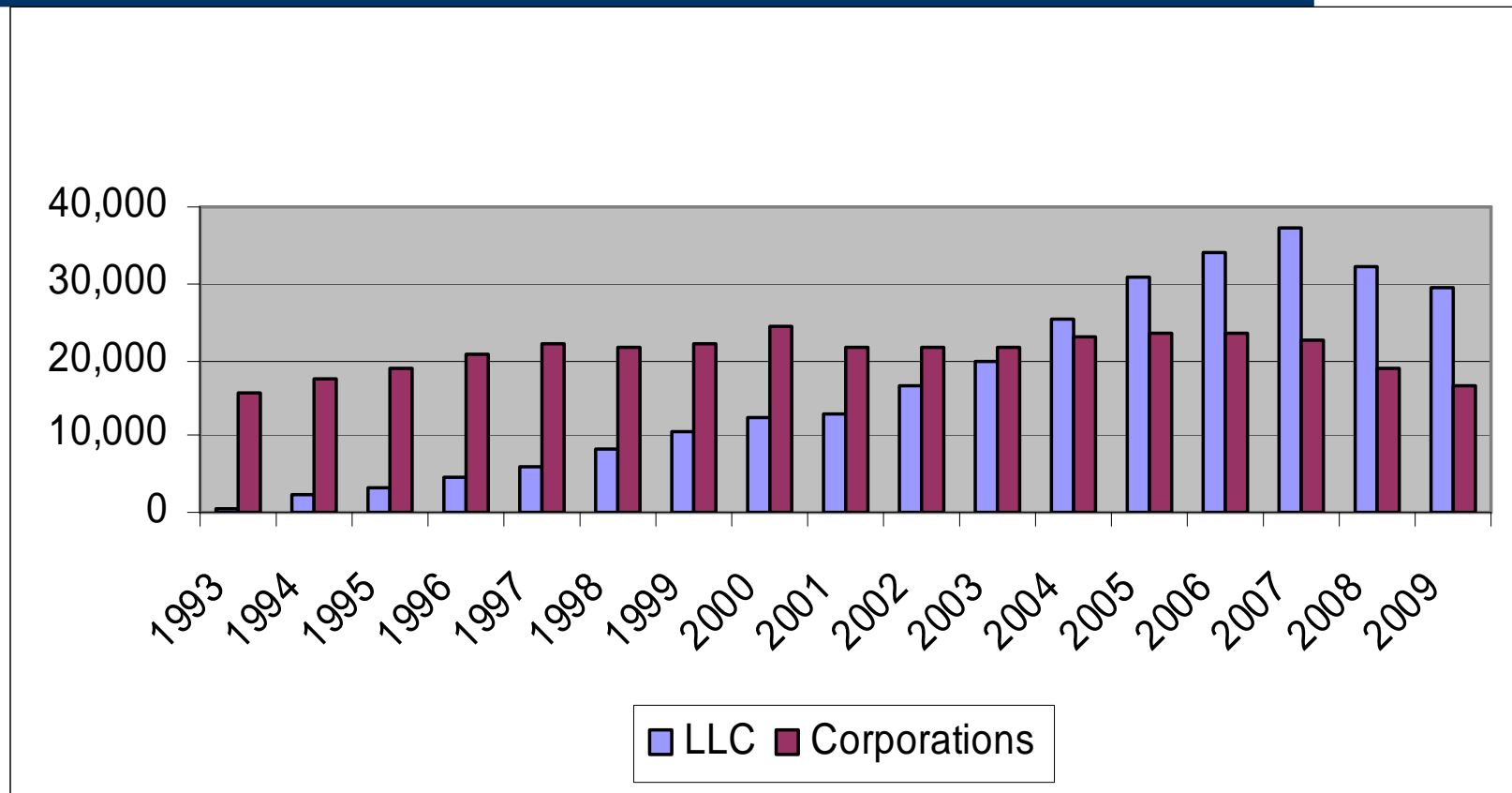


Limited Liability Companies

North Carolina LLC Creations



Growth in LLCs and Corporations



S Corps and LLCs

	S Corp	LLC
Pass-through	Yes	Yes
Ownership	Typically by individuals – in closely held, family owned business	Individuals, corporations, partnerships, or other LLCs
Owners' liability limited	Yes	Yes
Subject to franchise tax	Yes	No



Current Business Entities

Business Corporation	<u>272,836</u>
Limited Liability Company	<u>231,273</u>
Limited Liability Partnership	<u>1,590</u>
Limited Partnerships	<u>12,946</u>
Professional Corporation	<u>14,585</u>
Professional Limited Liability Company	<u>5,891</u>
Total	<u>539,121</u>

Annual Report Requirements

Entity	Report	Fee
Corp	Yes	\$25 paper; \$18 online
Professional Corp	No	N/A
LLC	Yes	\$200
Professional LLC	No	N/A
Limited Partnership	No	N/A
Limited Liability Partnership	Yes	\$200

Tax Reform Options

- Broaden base, lower rate by:
 - Treating LLCs the same as S corps
 - Treating all business entities whose owners have limited liability the same
- 2009 House Budget , Sec. 27B.2, SB 202, 6th Ed., expanded franchise tax to all limited liability businesses



Tax Reform Options

- 21st Century Tax Rate Reduction and Modernization Plan
 - Expands franchise tax to all limited liability businesses
 - Repeals all other State and local privilege license taxes
 - Repeals the annual corporate report fee

