



# Comprehensive Tax Reform

## North Carolina's Recent Experience

Robert Bowles, NC Department of Revenue

Ed McLenaghan, NC Office of State Budget & Management



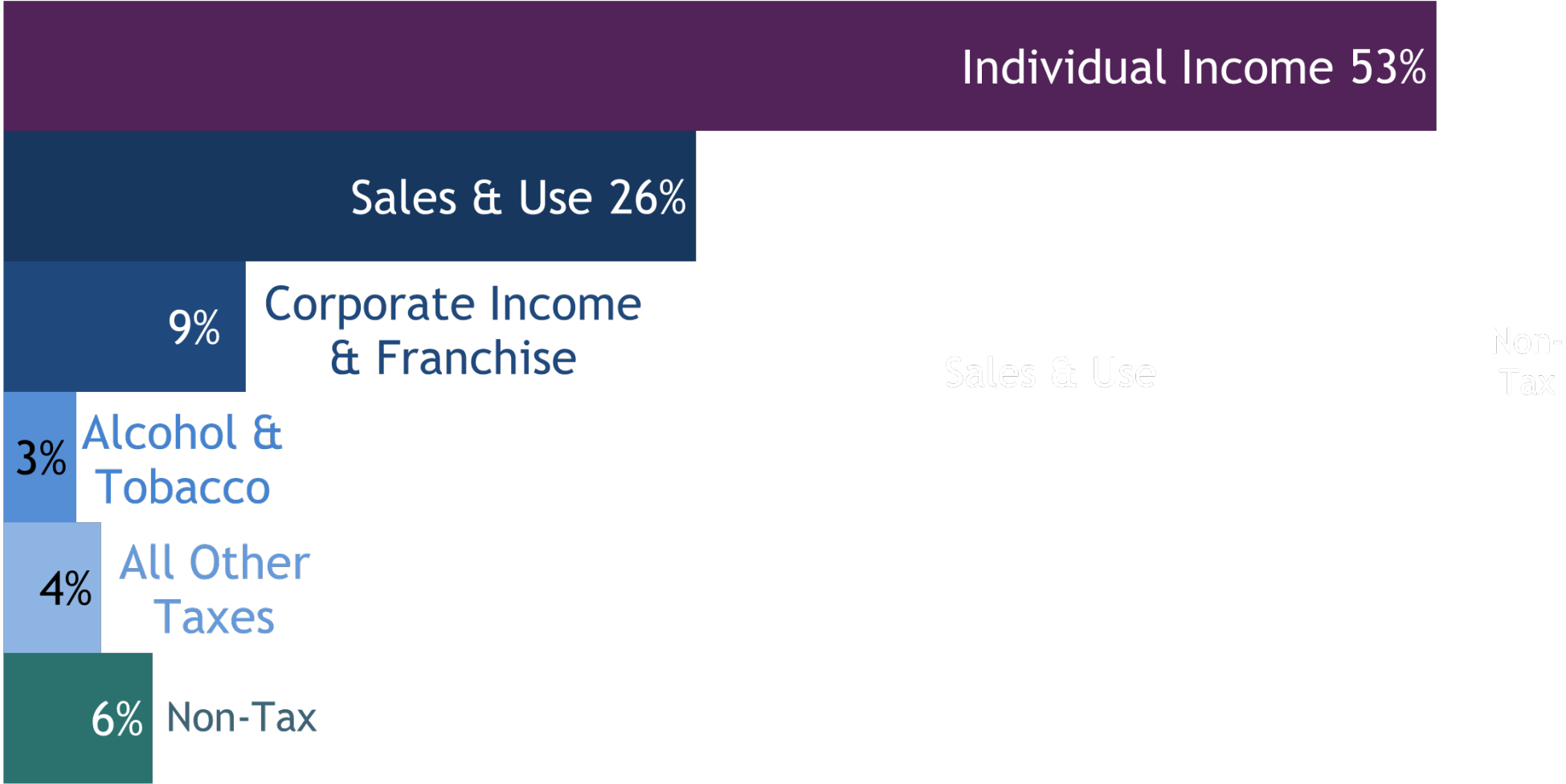
Tax Reform: It's even more complicated than it looks.

The image displays several mathematical formulas, likely related to probability density functions and their derivatives, overlaid on a dark background. The formulas are written in white and include:

- $$\frac{\partial}{\partial a} \ln f_{a, \sigma^2}(\xi_1) = \frac{(\xi_1 - a)}{\sigma^2} f_{a, \sigma^2}(\xi_1)$$
- $$\int_{\mathbb{R}_n} T(x) \cdot \frac{\partial}{\partial \theta} f(x, \theta) dx = M \left( T(\xi) \cdot \frac{\partial}{\partial \theta} \ln L(\xi, \theta) \right)$$
- $$\int_{\mathbb{R}_n} T(x) \cdot \left( \frac{\partial}{\partial \theta} \ln L(x, \theta) \right) \cdot f(x, \theta) dx = \int_{\mathbb{R}_n} T(x) \cdot \left( \frac{\frac{\partial}{\partial \theta} f(x, \theta)}{f(x, \theta)} \right) \cdot f(x, \theta) dx$$
- $$\frac{\partial}{\partial \theta} \int_{\mathbb{R}_n} T(x) f(x, \theta) dx = \int_{\mathbb{R}_n} \frac{\partial}{\partial \theta} T(x) f(x, \theta) dx$$

# North Carolina's Tax System in 2013

Individual Income & Sales Taxes Comprise Vast Majority of Revenue



FY 2012-13 General Fund Revenues

Source: NC Department of Revenue data



# Tax Reform Becomes Law July 2013

## GOP has majority to update state's tax structure

Posted December 14, 2012

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By Mark Binker  
RALEIGH, N.C. — It that got nods from secrets on t

INDUSTRY NEWS > HEALTH CARE

## Is there hope for tax reform in NC? McCrory seems doubtful

## Cities could lose revenue under tax reform

Bob Rucho, Andrew Brock, Austin Allran

2013

Reactions

Reactions

**House, Senate, governor reach tax deal**

Taxes

July 15, 2013  
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**Realtors remain wary of NC tax reform**

Posted July 16, 2013

CARY, N.C. — North Carolina real estate agents aren't thrilled with the tax reform plan that Gov. Pat McCrory could sign into law as early as the end of the week, but they say it could have been much worse on large businesses privilege taxes

GARNER CLEVELAND RECORD MAY 11, 2013 7:07 AM

## Senate GOP debuts far-reaching tax overhaul

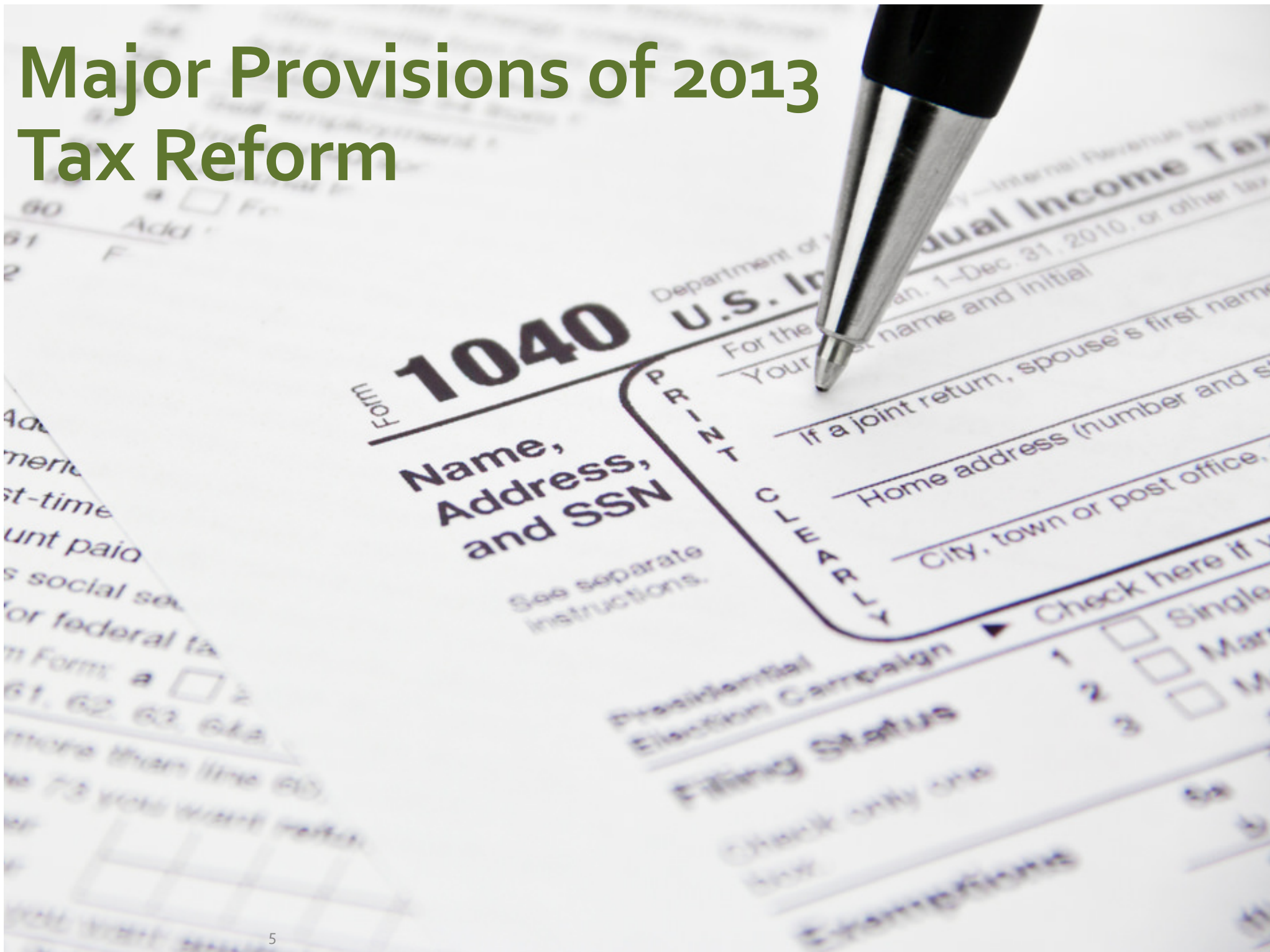
HIGHLIGHTS

A much-anticipated income tax overhaul by cutting personal and corporate income taxes in exchange for repairs made its debut Tuesday in the

By John POSTED 6:16 PM, JULY 16, 2013. BY MITCH CARR  
A far-reaching plan by affect the wallet of every North Carolina resident. The cost of food, prescription drugs and more than 100

**Tax reform bill passes NC House and Senate**

# Major Provisions of 2013 Tax Reform



# Individual Income Taxes

## **Tax Rates:**

Graduated to flat

## **Deductions:**

Bigger standard, fewer itemized  
Business income deduction repealed

## **Exemptions:**

Personal exemption & others repealed

## **Credits:**

Several sunset, others repealed, one expanded



# Consumption Taxes

## **Gross Receipts to Sales Tax:**

Electricity, natural gas, live entertainment, and movies

## **Exemptions & Preferential Rates:**

Several repealed, several extended

## **Base Expansions:**

Admission charges, service contracts



# Corporate Income & Other Taxes

## Corporate Income Tax Rates:

Two certain rate cuts, two performance-based

## Repeals:

Estate tax, earmark for school construction

## Incentives:

Extension of R&D credit

Sunset of major jobs & investment credits

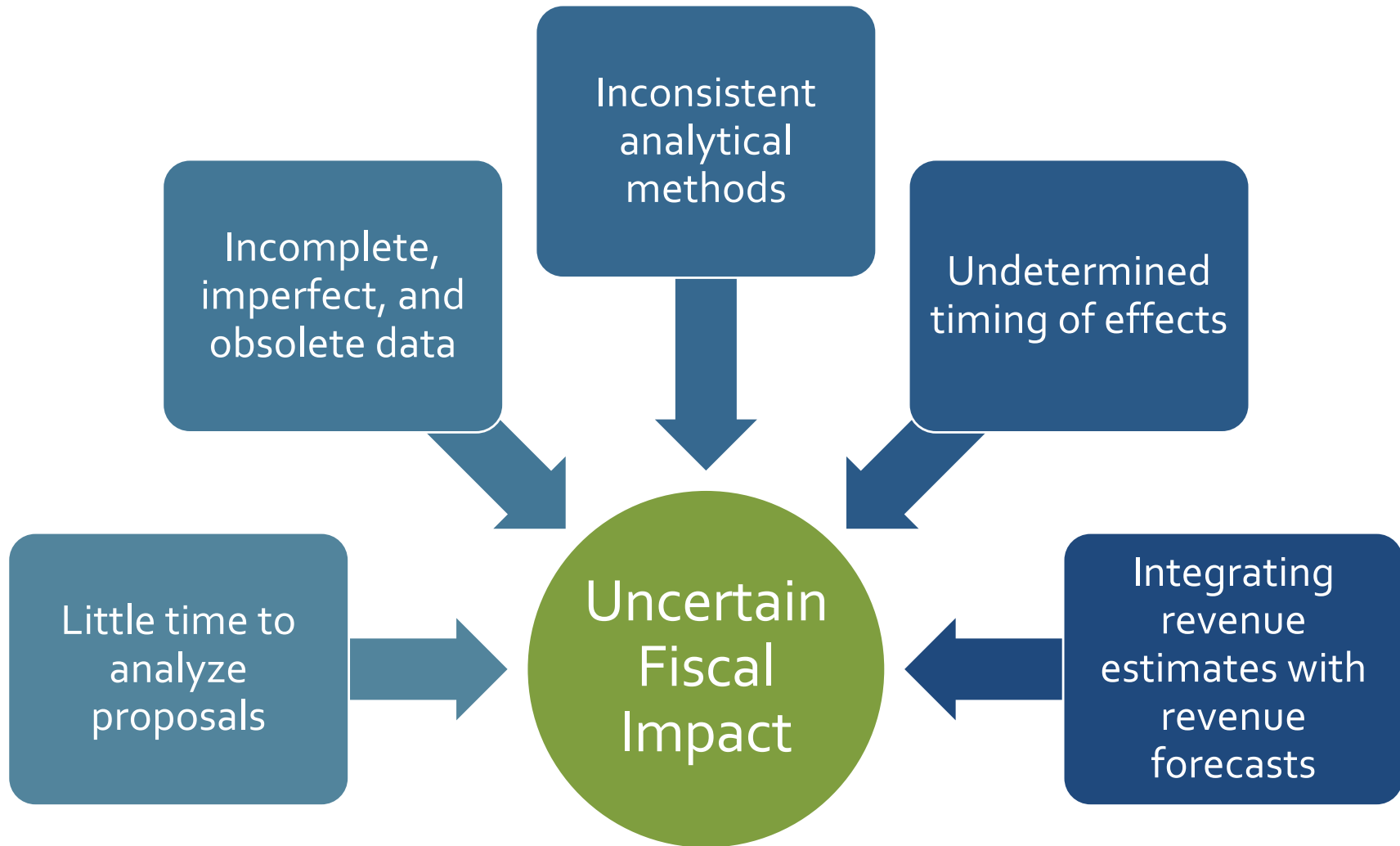






# Challenges Quantifying the Effects of Tax Reform

# Quantifying Tax Reform: Challenges



# Quantifying Tax Reform: Challenges

## **Fiscal Impact:**

How Big?

Potential Error?

## **Revenue Forecast:**

Timing of Impacts?

## **Assessing Impacts:**

Tracking Revenues

Impact Error or Forecast Error?



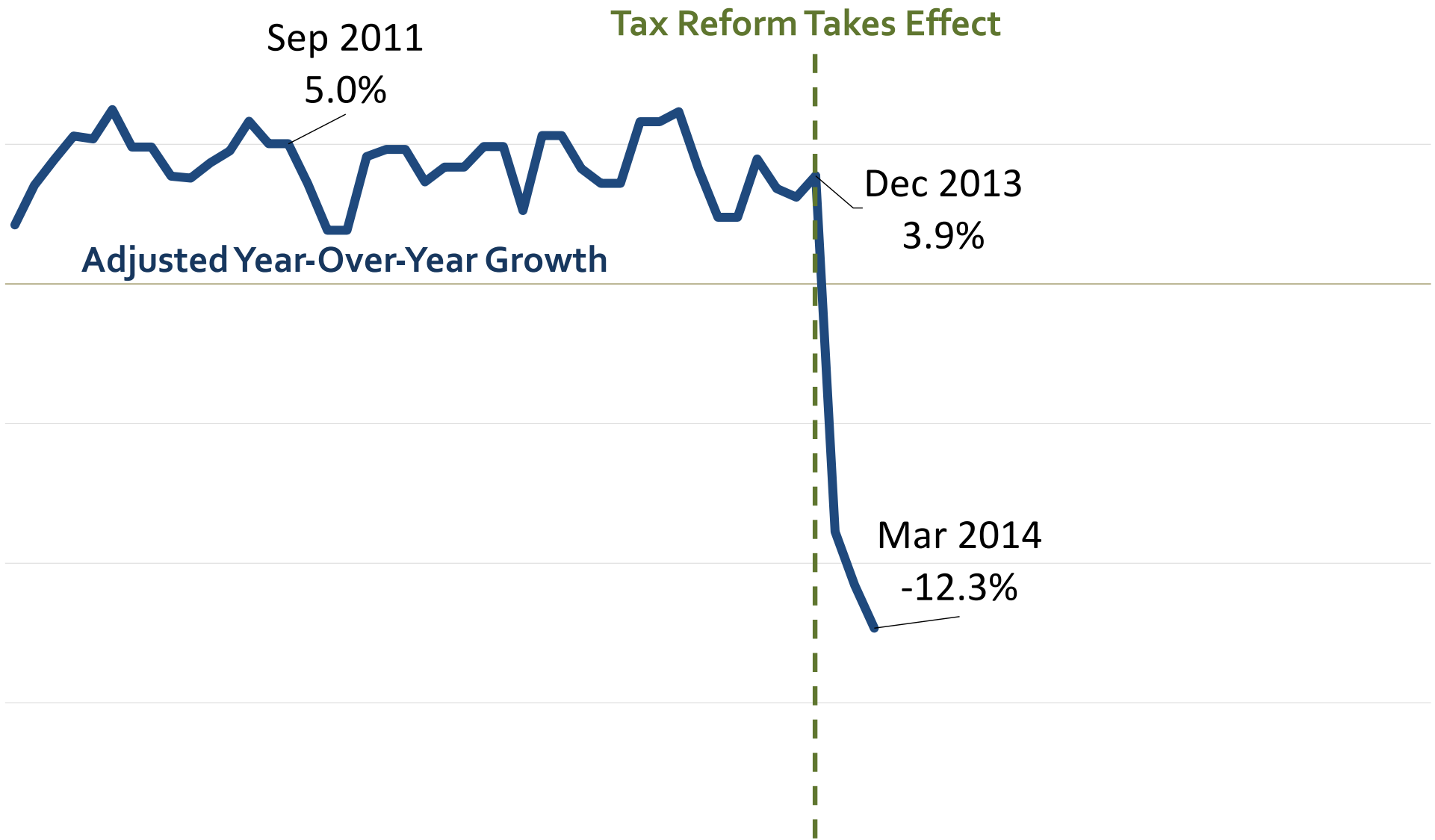
# Revenue Trends After Tax Reform

## Initial Impacts

Withholding plummets in first months of 2014



# Withholding Drops Sharply After Tax Reform



Source: NC Department of Revenue data

# Implementation of Tax Reform

## Initial Impacts

Withholding plummets in first months of 2014

Negative April surprise

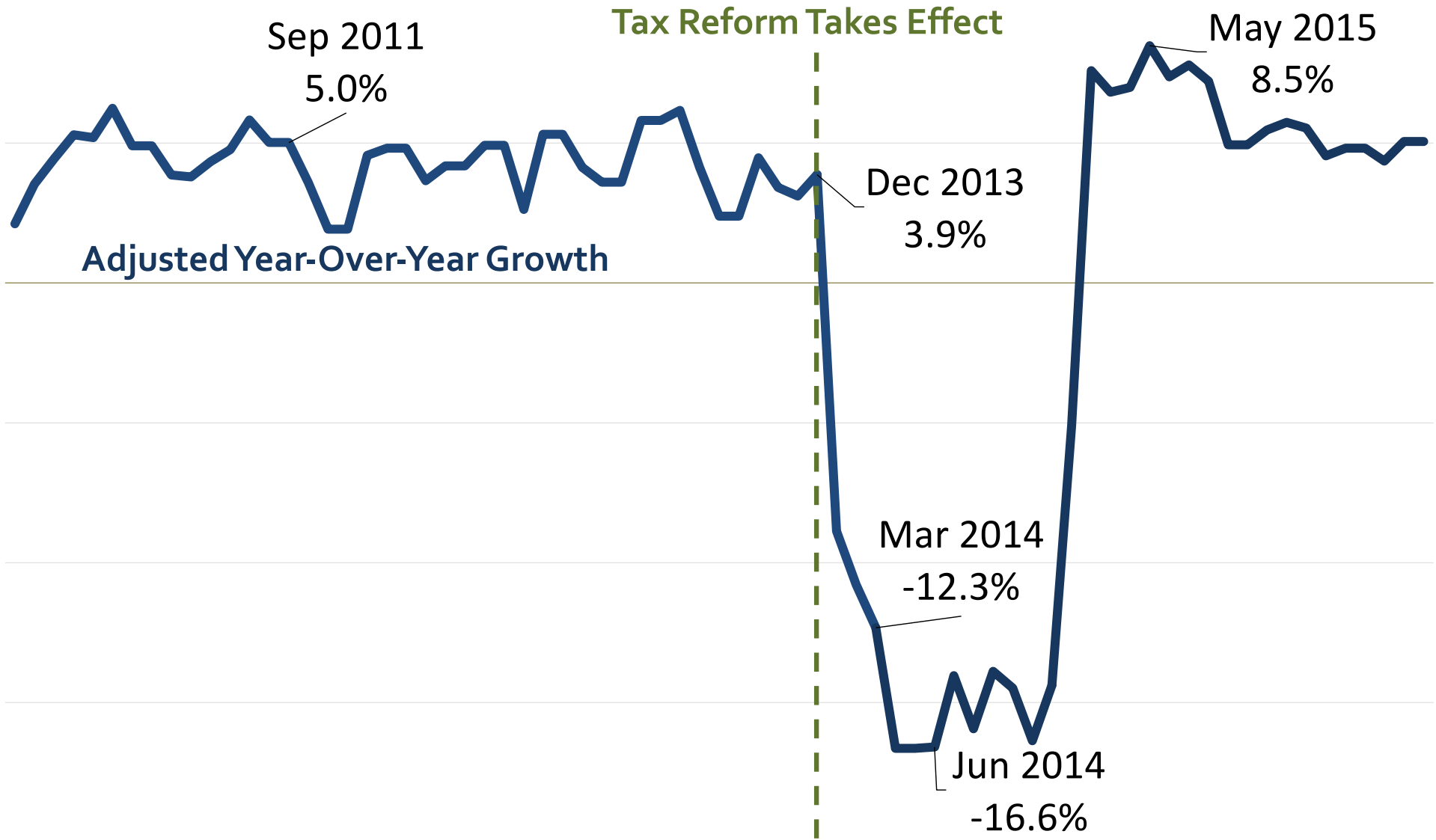
Downward revisions to forecasts

Withholding continues to disappoint through 2014

Big reversals in early 2015



# Withholding Drops Sharply After Tax Reform



Source: NC Department of Revenue data

# The Impacts of Tax Reform





# Implementation of Tax Reform

## **Personal Income Tax:**

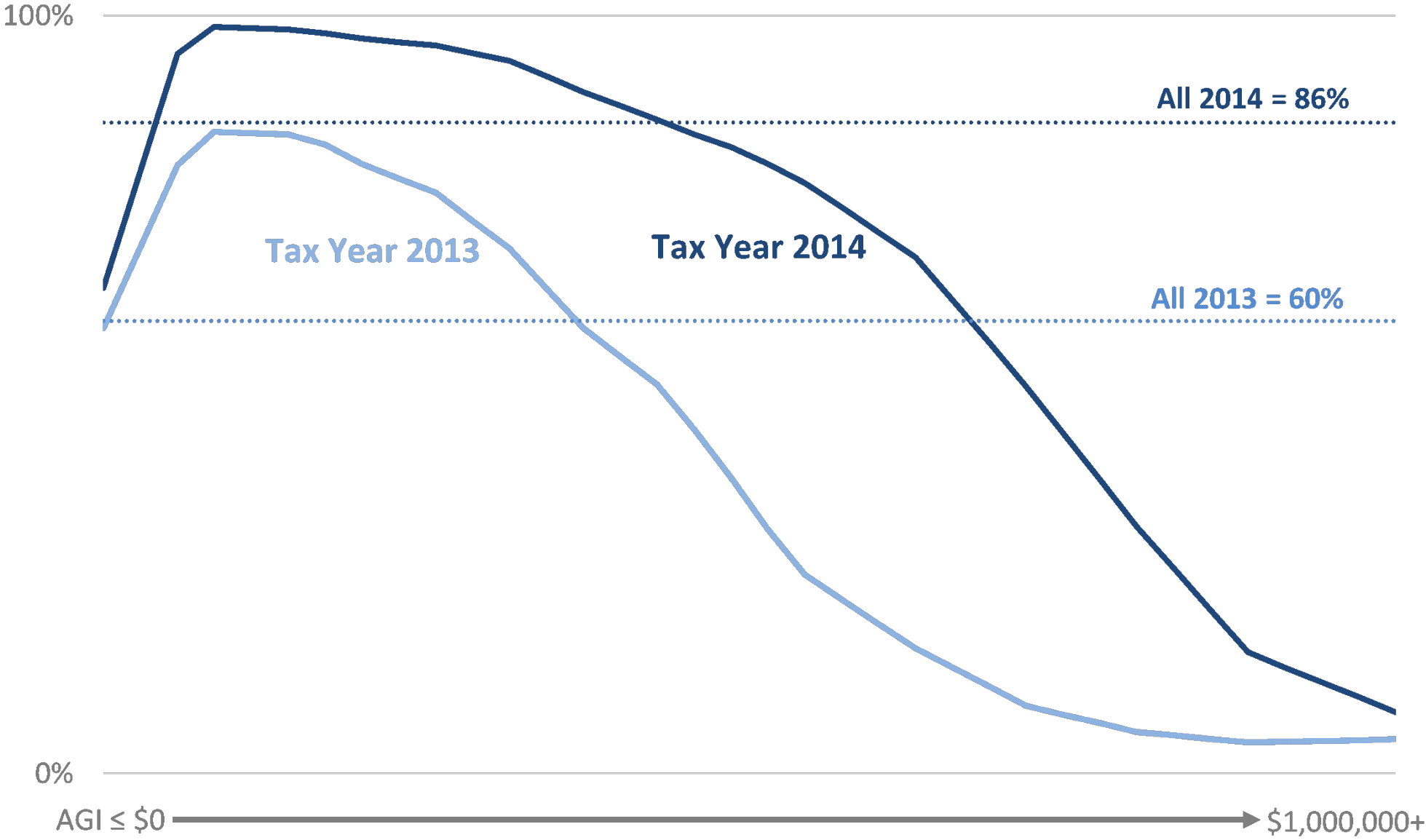
New Withholding Certificates & Tables  
Simplified Tax Return & Instructions

## **Sales & Use Tax:**

Multiple Implementation Dates  
Timing Issues

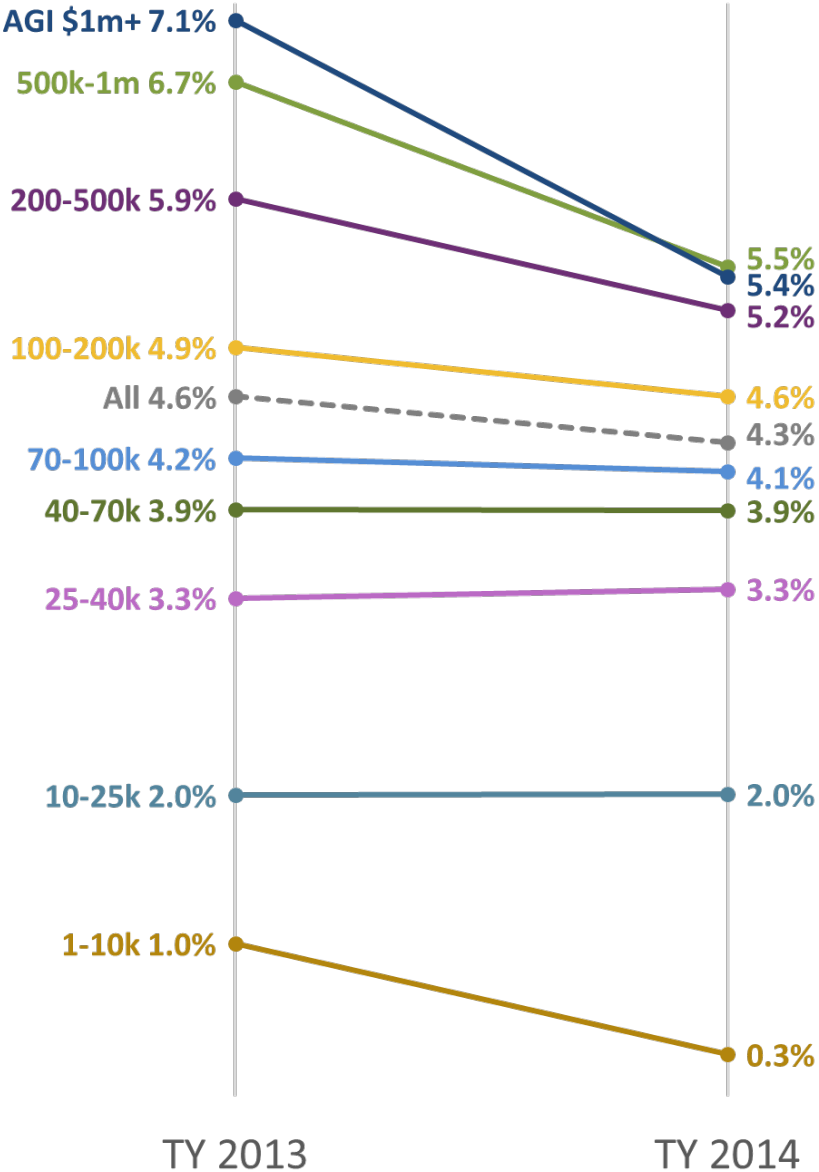


# Many More Filers Claim Standard Deduction



Source: NC Department of Revenue data

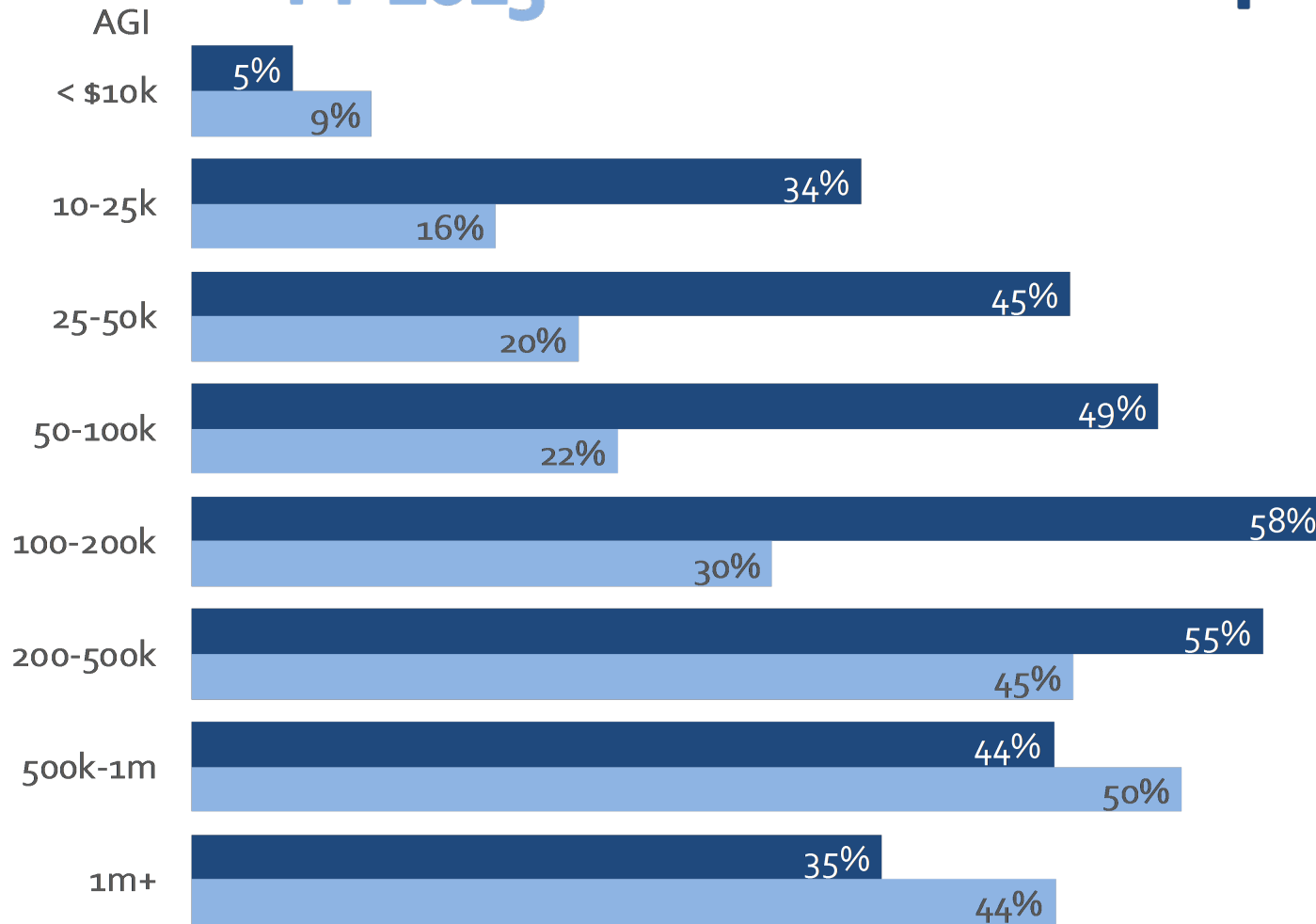
# Effective Tax Rates Fall at Top & Bottom



Source: NC Department of Revenue data

# Share of Filers With Balance Due Doubled

All Resident **19%** **TY 2013** → **38%** **TY 2014**



Source: NC Department of Revenue data

# Impact of Tax Reform: Looking Back

## **Personal Income Tax:**

Many more filers claim standard deduction

Fiscal impact at high end of range

Biggest tax cuts at highest & lowest incomes

## **Sales & Use Tax:**

Likely underestimate of some fiscal impacts

## **Corporate Income Tax:**

Change in overpayments applied to estimated tax



# Additional Rounds of Tax Reform

## **Personal Income Tax:**

Medical expenses

Increases in standard deduction

Higher withholding rate

Further rate reduction

## **Corporate Taxes:**

Additional rate cuts

Phase in sales-only apportionment

Sunset of major credits



# Additional Rounds of Tax Reform

## **Sales and Use Tax:**

Two rounds of base expansions for repair, maintenance, and installation services

Adjust local distribution

## **Other Taxes:**

Eliminate local privilege license taxes



# Lessons for Other States

Ensure detailed, reliable data

Develop consensus on analytical methods

Coordinate across agencies and branches

Plan ahead for real-time evaluation





# Appendices



Personal Income Taxes	2013	2014
Tax Rates	6.0% to 7.75%	5.8%
Standard Deduction	\$6,000 (MFJ); Additional blind/elderly deduction	\$15,000 (MFJ)
Itemized Deductions	Federal excluding state income and sales taxes	Charitable contributions; Real estate taxes and mortgage interest (capped at \$20,000)
Personal Exemptions	\$2,500 below \$100,000 AGI; \$2,000 otherwise (MFJ)	Repealed
Other Notable Deductions	\$50,000 business income deduction; \$2,000/\$4,000 retirement income deduction	Repealed
Credits	\$100 per child credit below \$100,000 AGI; Dependent care credit; Non-itemizer charitable credit; Many smaller credits	Sunset of EITC; Additional \$25 child credit for AGI below \$40,000 (MFJ); Eliminate dependent care credit, non-itemizer charitable credit, real-property donation credit, and others

# Major Provisions of 2013 Tax Reforms

## Consumption Taxes

Good/service	2013	2014
Electricity	3.0% sales tax; 3.22% gross receipts tax	7.0% state sales tax w/ local distribution
Natural gas	Tax dependent upon amount purchased	7.0% state sales tax w/ local distribution
Admission charges for live entertainment	3.0% gross receipts tax	Subject to state and local sales tax rates
Movies	1.0% gross receipts tax	Subject to state and local sales tax rates
Other Changes		
<ul style="list-style-type: none"> <li>- Repealed exemptions: service contracts, food sold in college/university dining halls, sales tax holidays, and several others</li> <li>- Caps/thresholds: minimum receipts threshold for farming exemptions, \$45 million cap on sales tax refunds for nonprofits</li> </ul>		



# Major Provisions of 2013 Tax Reforms

## Corporate Income & Other Taxes

Provision	2013	2014	2015
Corporate Income Tax Rate	6.9%	6.0%	5.0%
Major Credits	Film, jobs, investment, low-income housing, renewables, historic rehabilitation, R&D	Film, low-income housing, renewables, historic rehabilitation, R&D	R&D, renewables

### Other Changes

- Estate tax repealed retroactively to January 1, 2013
- Adopted automatic tax-revenue triggers to reduce CIT rate to 4% in 2016 and 3% in 2017 if total General Fund tax revenues exceeded a specified threshold
- Credit for renewable energy property sunset after 2015; Redesigned historic rehabilitation credit adopted for 2016
- Film credit replaced with a grant program in 2015
- Corporate income tax earmark for school construction repealed
- Extended sunset of business incentives for R&D, motorsports teams, and airlines
- Required studying additional changes, many of which later became law

