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North Carolina Legislature Overrides Governor's Veto and Enacts Budget Bill – Corporate Rate Reduction and other Tax Changes

Summary

North Carolina has enacted a budget bill, S.B. 257, which, among other things, reduces the state's corporate income tax rate from 3 percent to 2.5 percent, effective for taxable years beginning on or after January 1, 2019. The governor had vetoed the bill, but on June 28, 2017, the legislature overrode that veto. The budget bill also includes a franchise tax rate reduction for S corporations, a rate reduction and other changes for personal income tax, and other sales and use tax changes.

Details

On June 22, 2017, the North Carolina Legislature passed S.B. 257, but the budget bill was subsequently vetoed by Governor Roy Cooper (D). On June 27, the State Senate voted to override the governor's veto, and the State House followed suit on June 28. As a result, the following are some of the North Carolina tax changes enacted by S.B. 257:

- For taxable years beginning on or after January 1, 2019, the North Carolina corporate income tax rate will be reduced from 3 percent to 2.5 percent.
- For taxable years beginning on or after January 1, 2019, the franchise tax on S corporations is reduced from $1.50 per one thousand dollars of an S corporation's tax base to $200 for the first $1 million of the tax base and $1.50 per one thousand dollars of the tax base that is greater than $1 million.
- Beginning in 2019, the personal income tax rate also will be reduced from 5.499 percent to 5.25 percent. In addition, the standard deduction is increased and modified, and the child tax credit is converted into a tax deduction.
- S.B. 257 also makes changes to North Carolina's sales and use taxes. Most notably, the budget bill repeals the one percent manufacturing machinery privilege tax effective July 1, 2018. Under current law, the sale of mill machinery to manufacturer is subject to the one percent privilege tax but capped at eighty-dollars per item. The budget bill also asks the Revenue Laws Study Committee to address how to clarify the scope of the sales and use tax exemption for mill machinery.
- In addition, the amended statute expressly provides sales and use tax exemptions on the following:
  - Sale of mill machinery or mill machinery parts or accessories to a manufacturing industry or plant; or a contractor or subcontractor performing a contract with the manufacturing industry or plant;
  - Sale of cranes, structural steel crane support systems (including related foundations), port and dock facilities, rail equipment, and material handling equipment to a major recycling facility;
  - Sale of certain equipment and parts that will be capitalized by a company primarily engaged in R&D activities in the physical, engineering, and life sciences;
  - Sale of certain equipment, attachment and parts that will be capitalized by a company primarily engaged in software publishing or machinery refurbishing activities;
  - Sale of machinery and equipment used to facilitate unloading or processing of bulk cargo at a ports facility in order to deliver the cargo to manufacturing facilities. Sale of certain parts and accessories related to such machinery and equipment are also exempt from sales and use tax;

- Sale of equipment, parts, fuel, natural gas, and electricity used by a secondary metal recycler;
- Sale of certain equipment and parts that will be used for extraction of precious metals or fabrication of metal products;
- Sale of repair or replacement parts for a ready-mix concreate mill.

- Effective July 1, 2017, equipment, accessories, attachments or parts sold to an applicable "Large Fulfillment Facility" is not subject to North Carolina sales and use tax. To qualify for this exemption, a "Large Fulfillment Facility" requires (1) an investment of one hundred million dollars within five years; (2) employment level of at least 400; and (3) primary use for receiving, inventorying, sorting, repackaging, and distributing retail products for fulfilling customer orders.
- Beginning July 1, 2017, an owner or lessee of a qualifying "transformative project" (as defined in G.S. 143B-437.51(9a)) under the North Carolina Job Development Investment Grant Program is entitled for a refund of sales and use tax paid on certain building materials building supplies, fixtures, and equipment.

Insights

- Taxpayers should make note of the North Carolina tax changes enacted as part of S.B. 257, including the corporate income tax rate reduction.
- Market-based sourcing implementing legislation that many expected to be enacted in this legislative session (originally introduced as S.B. 325) was not part of the budget bill. As a result, despite final administrative rules having been issued earlier this year as a result of 2016 legislation, the adoption of market-based sourcing for receipts from services and intangibles is uncertain at this time.
- Taxpayers affected by North Carolina's rate change should consult with their financial statement auditor and tax advisor to evaluate and determine the potential financial statement implications under ASC 740, including the impact on current and deferred taxes, uncertain tax benefits, and disclosures.