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# Leading by Example: Putting North Carolina's Tax Reforms into National Context

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# About the Tax Foundation

- The Tax Foundation is an independent tax policy 501(c)(3) nonprofit. Since 1937, our principled research, insightful analysis, and engaged experts have informed smarter tax policy at the federal, state, and global levels. For over 80 years, our goal has remained the same: to improve lives through tax policies that lead to greater economic growth and opportunity.
- Principles of sound tax policy:
  - Simplicity
  - Transparency
  - Neutrality
  - Stability

# North Carolina: the foremost leader in pro-growth state tax reform over the past decade

- North Carolina has been the foremost leader in pro-growth state tax reform over the past decade and is shaping up to be the front runner in pro-growth state tax reform over the next decade.
- North Carolina's tax reforms are exceptional:
  - They were accomplished in one legislative session (2013), with further progress made in subsequent years.
  - They were comprehensive.
  - They used tax triggers.

# North Carolina's Tax Reforms: 2013

- Consolidated three PIT brackets into one, reducing top marginal rate of 7.75% to flat rate of 5.75% over two years.
- Reduced CIT rate by 3.9 percentage points over four years.
- Increased standard deduction and child tax credit.
- Repealed personal exemption.
- Streamlined PIT and CIT credits.
- Broadened sales tax base.
- Repealed the estate tax.

**North Carolina Individual Income Tax Rates, Before and After Reform**

2013		2014	2015	2016
6%	\$0-\$12,750	5.80% \$0	5.75% \$0	5.75% \$0
7%	\$12,750-\$60,000			
7.75%	\$60,000+			

**North Carolina Corporate Income Tax Rates, Before and After Reform**

2013	2014	2015	2016	2017
6.90% \$0	6% \$0	5% \$0	4% \$0	3% \$0

# North Carolina's Tax Reforms: 2014

- Converted the net economic loss deduction into a better-structured state net loss deduction more in line with the federal net operating loss (NOL) deduction.
- Eliminated municipal authority to levy privilege license taxes.

# North Carolina's Tax Reforms: 2015

- Lowered PIT rate from 5.75% (2016) to 5.499% (2017).
- Increased standard deduction from \$15,000 to \$15,500 (MFJ).
- Modified CIT triggers slightly to ensure they took effect regardless of the year in which the revenue target was reached.
- Expanded sales tax base to include service contracts, such as repair, maintenance, and installation services.

# North Carolina's Tax Reforms: 2017

- Reduced PIT rate from 5.499% (2018) to 5.25% (2019-2021).
- Reduced CIT rate from 3% (2018) to 2.5% (2019).
- Reduced franchise taxes for S corporations.

# North Carolina's Tax Reforms: 2021

- Reduces the PIT rate to 3.99% by 2027.
- Phases out the CIT altogether (starting in 2025, with phaseout complete by 2030).
- Increases the standard deduction.
- Increases the child deduction.
- Reduces franchise taxes while simplifying the base.
- Exemptions military pension income from taxation.

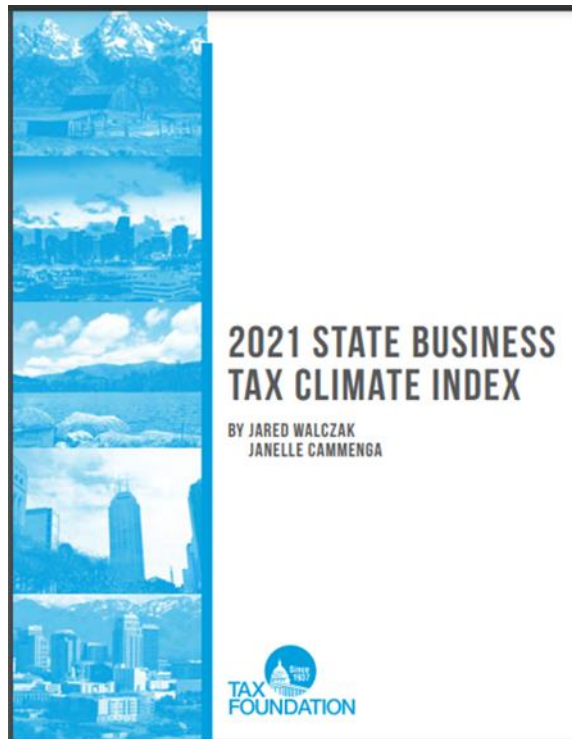


# Tax Reform in North Carolina: 2013-2021

North Carolina's Income Tax Rates		
	PIT	CIT
2013	6% > \$0 7% > \$12,750 7.75% > \$60,000	6.90%
2014	5.80%	6%
2015	5.75%	5%
2016	5.75%	4%
2017	5.499%	3%
2018	5.499%	3%
2019	5.25%	2.50%
2020	5.25%	2.50%
2021	5.25%	2.50%

	PIT	CIT
2022	4.99%	2.50%
2023	4.75%	2.50%
2024	4.60%	2.50%
2025	4.50%	2.25%
2026	4.25%	2%
2027	3.99%	2%
2028	3.99%	1%
2029	3.99%	1%
2030	3.99%	0%

# North Carolina's Tax Competitiveness



North Carolina	
Tax Type	Rank
Overall Rank	10
Corporate Taxes	4
Individual Taxes	16
Sales Taxes	22
Property Taxes	26
Unemp. Insur. Taxes	10

Projected rankings once 2021 reforms are fully phased in:

- Overall Rank: 5
- Corporate Taxes: 1
- Individual Taxes: 13
- Sales Taxes: 22
- Property Taxes: 26
- Unemp. Insur. Taxes: 10

# Major State Tax Changes Across the U.S. Over the Past Decade

- The Good:
  - Indiana (ranks 9<sup>th</sup> on the *Index*)
  - Utah (ranks 8<sup>th</sup> on the *Index*)
  - The District of Columbia's 2014 reforms
- The Bad:
  - Tax increases in states like NY, NJ, CA, NM
  - Gross receipts taxes in Ohio, Texas, and Oregon
- The Ugly:
  - Kansas

# Indiana and Utah remain competitive with North Carolina

- Indiana reduced its CIT rate by 42%, ended its inheritance tax, repealed its throwback rule, reduced reliance on TPP taxes, and created an incentives review process.
- Utah consolidated six PIT brackets into one, lowered the PIT rate, repealed certain deductions, lowered the general sales tax rate, and lowered the sales tax rate on food.

# D.C. remains uncompetitive overall but adopted structurally sound reforms in 2014

- Lowered PIT and franchise tax rates
- Increased standard deduction and personal exemption
- Broadened sales tax base to additional personal services
- Expanded the EITC
- Used tax triggers

# What went wrong in Kansas?

- Enacted substantial tax cuts in 2012 without offsets or spending cuts, creating a hole in the budget.
- Exempted pass-through business income from taxation while requiring personal wage income to continue to be taxed under the PIT and corporate income to continue to be taxed under the CIT.

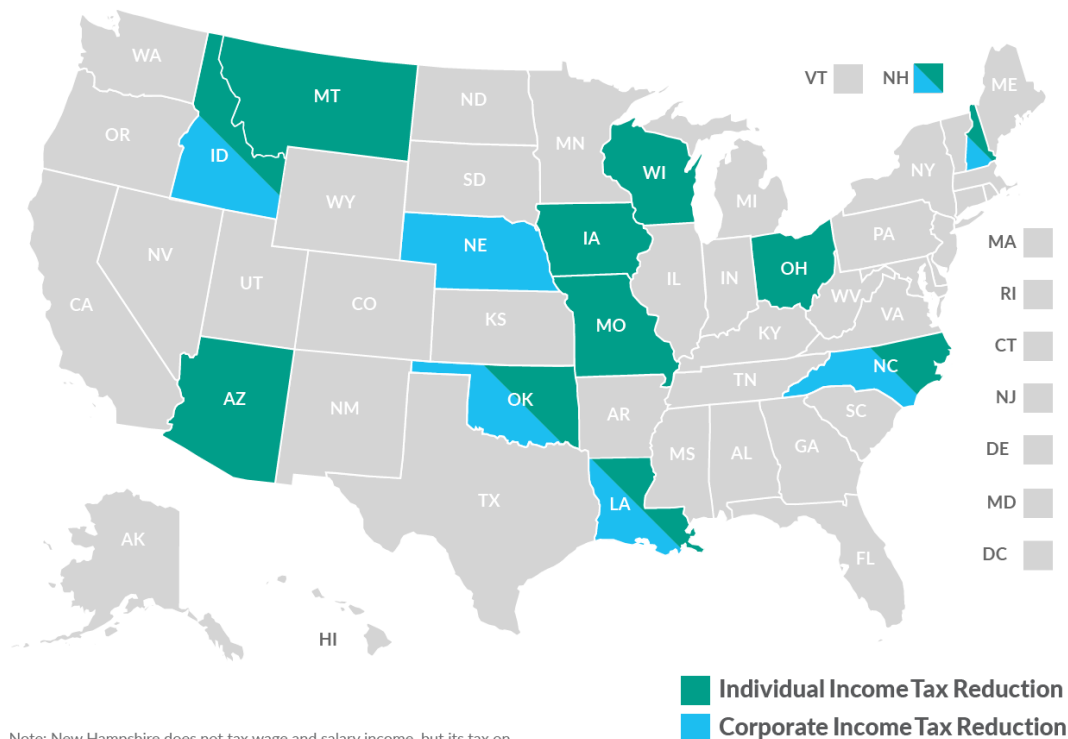
# Several states have enacted GRTs in recent years

- Ohio's Corporate Activity Tax (CAT): 2005
- Texas' Margin Tax: 2008
- Oregon's Corporate Activity Tax (CAT): 2019

# State Income Tax Cuts Enacted in 2021

## Twelve States Have Enacted Laws in 2021 to Reduce Income Tax Rates

States That Have Enacted Income Tax Rate Reductions in 2021 (as of November 29, 2021)



Note: New Hampshire does not tax wage and salary income, but its tax on individual interest and dividends income will phase out over time.  
Source: Tax Foundation.

- In 2021 alone, 12 states have enacted laws to reduce their income tax rates.
- Four additional states implemented income tax cuts this year that were enacted in previous years.
- Several of these states paired these reductions with other pro-growth reforms.



# Trends in State Tax Reform: 2011-2021

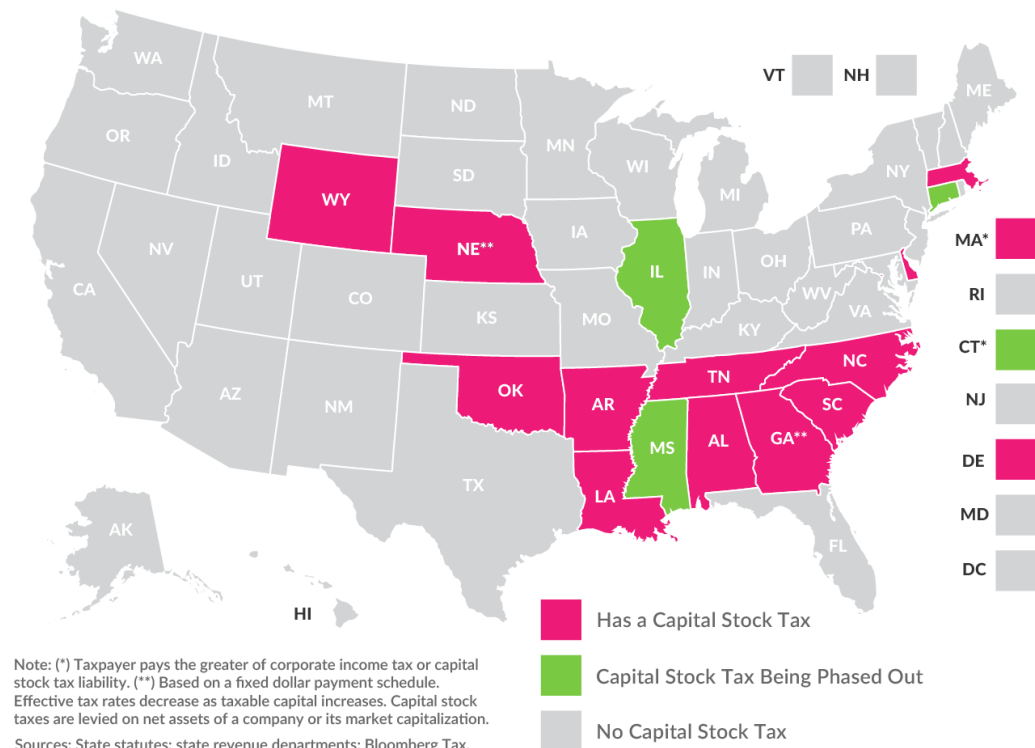
- Transformational, pro-growth tax reform is usually a multi-year effort.
- Tax triggers help ensure tax reductions are implemented responsibly.

# What's Next for North Carolina?

- North Carolina should prioritize reducing the franchise tax rate and ultimately phasing it out.
- Further sales tax base broadening could pay down further franchise or income tax reductions.

## Does Your State Have a Capital Stock Tax?

State Capital Stock Taxes as of January 1, 2021





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# Questions?

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