



AN ALERT FROM SMITH LEONARD PLLC:

## Smith Leonard Tax Update



 Subject

**YEAR IN REVIEW: NORTH CAROLINA TAX CHANGES EFFECTIVE  
JANUARY 1, 2014**

### CONTACT:

**Kevin Benson – Tax Partner**

336.821.1402

[kbenson@smithleonardcpas.com](mailto:kbenson@smithleonardcpas.com)

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**Mark Bulmer – Tax Partner**

336.821.1411

[mbulmer@smithleonardcpas.com](mailto:mbulmer@smithleonardcpas.com)

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**Jon Glazman – Tax Partner**

336.821.1407

[jglazman@smithleonardcpas.com](mailto:jglazman@smithleonardcpas.com)

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**Addison Maille – Tax Partner**

336.821.1304

[amaille@smithleonardcpas.com](mailto:amaille@smithleonardcpas.com)

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## YEAR IN REVIEW: NORTH CAROLINA TAX CHANGES EFFECTIVE JANUARY 1, 2014

### SUMMARY

Throughout 2013, several tax bulletins and updates were released that communicate changes effective in the 2014 tax year. Changes include reduction in the corporate and personal income tax rates, the elimination of the NC Estate Tax, a cap on the state gas tax, and tax added to the sales price of a service contract. We've done our best to summarize and highlight the changes that may affect you or your business.

### CORPORATE INCOME TAX

**Corporate income tax rate reduced:** Effective for tax years beginning on or after January 1, 2014, the corporate tax rate is reduced from 6.9% to 6%, and further reduced to 5% in 2015. The rate would be further reduced to 4% in 2016 and to 3% in 2017 provided that the state meets revenue targets.

**Corporate income tax credits repealed:** Effective for tax years beginning on or after January 1, 2014, the following corporate income tax credits are repealed: tax credit for construction of dwelling units for handicapped persons; credit for certain real property donations; credit for conservation tillage equipment; credit for gleaned crop; credit for certain telephone subscriber line charges; credit for savings and loan supervisory fees; and credit for construction of poultry composting facility.

### PERSONAL INCOME TAX

**Personal income tax rate reduced:** The current 3-tiered state personal income tax rate is replaced with a flat tax of 5.8% for the 2014 tax year and 5.75% for post-2014 tax years. Currently, the personal income tax rates range from 6% to 7.75%.

**Standard deduction:** Effective for taxable years beginning on or after January 1, 2014, the standard deduction amounts based on filing status have been increased as follows: \$15,000, married filing jointly (currently, \$6,000); \$12,000, head of household (currently, \$4,400); \$7,500, single and married taxpayers filing separately (currently, \$3,000).

**Itemized deductions:** Effective for taxable years beginning on or after January 1, 2014, the itemized deductions are limited to charitable contributions, personal residence interest, and real property taxes. However, the deduction for personal residence interest and real property



taxes is capped at \$20,000.

**Personal exemption allowance:** Effective for taxable years beginning on or after January 1, 2014, the personal exemption is repealed.

**Other personal income tax deductions:** Effective for taxable years beginning on or after January 1, 2014, deductions have been repealed for the following: severance wages; compensation for pecuniary loss suffered by reason of erroneous conviction and imprisonment; certain retirement benefits; tobacco settlement participants; firefighters and rescue squad workers; sales of manufactured home community; deferred cancellation of indebtedness; net business income; contributions to a Parental Saving Trust Fund of the State Education Assistance Authority; and educator expenses.

**Personal income tax credits:** Effective for taxable years beginning on or after January 1, 2014, the following personal income tax credits are repealed: credit for construction of dwelling units for handicapped persons; credit for child care and certain employment related expenses; credit for certain real property donations; credit for conservation tillage equipment; credit for gleaned crops; credit for the disabled; credit or partial refund for tax paid on certain federal retirement benefits; credit for property taxes paid on farm machinery; credit for construction of a poultry composting facility; credit for charitable contributions by nonitemizers; and education expenses credit. In addition, effective for taxable years beginning on or after January 1, 2014, the credit for children is increased from \$100 to \$125 for joint filers making up to \$40,000; heads of household making up to \$32,000; singles and married filing separately making up to \$20,000.

**Lottery winnings:** Effective for taxable years beginning on or after January 1, 2014, the amount of North Carolina income taxes that the North Carolina State Lottery Commission must withhold from the payment of winnings that are at least \$600 is a percentage based on the personal income tax rate. Currently, the amount of taxes to be withheld is 7% of the winnings.

#### **ESTATE TAX REPEALED**

Applicable to the estates of decedents dying on or after January 1, 2013, the estate tax is eliminated.

#### **SALES AND USE TAX**

**Manufactured and modular homes:** Applicable to sales made on or after January 1, 2014, the following sales and use tax rates have increased: manufactured homes, from 2% to the general rate of 4.75%; and modular homes, from 2.5% to the general rate of 4.75%. However, the sales of both manufactured and modular homes are excluded from the 1% local sales and use tax, effective January 1, 2014.



**Sales of piped natural gas:** Applicable to gross receipts billed on or after July 1, 2014, the combined general rate applies to the gross receipts derived from sales of piped natural gas. Effective July 1, 2014, the piped natural gas excise tax is repealed. Previously, sales of piped natural gas were excluded from the sales and use tax, and were instead subject to the piped natural gas excise tax in lieu of the sales tax.

**Sales of electricity:** Applicable to gross receipts billed on or after July 1, 2014, the combined general rate applies to the gross receipts derived from sales of electricity. Previously, sales of electricity were subject to the 3% state rate of sales tax, except for certain sales of electricity to commercial laundries and dry cleaners, which were subject to the 2.83% state rate of sales tax.

**Sales and use tax exemptions:** Effective January 1, 2014, the following sales and use tax exemptions have been repealed: nutritional supplements sold by a chiropractic physician at a chiropractic office to a patient as part of the patient's plan of treatment; meals and food products served to students in dining rooms regularly operated by North Carolina or private educational institutions or student organizations; and sales of newspapers by newspaper street vendors, by newspaper carriers making door-to-door deliveries, and by means of vending machines. Applicable to purchases made on or after July 1, 2014, the state sales and use tax exemption is repealed for bread, rolls, and buns sold at a bakery thrift store; and the respective local sales tax limitation is repealed. Applicable to sales made on or after January 1, 2014, the exemption for food sold not for profit by public or private school cafeterias within the school buildings during the regular school day has been modified so that the exemption applies to food sold not for profit by a nonpublic or public school, including a charter school and a regional school, within the school building during the regular school day. Applicable to purchases made on or after July 1, 2014, the August sales tax holiday and the Energy Star sales tax holiday have been eliminated.

**Effective date of sales and use tax changes:** Effective January 1, 2014, the provision applicable to the effective date of tax changes on services has been modified to apply to tangible personal property, digital property, or services.

**Sales and use tax refunds:** The sunset dates for the annual sales and use tax refunds paid by the following taxpayers have been extended from January 1, 2014 to January 1, 2016: interstate passenger air carriers; motorsports teams or sanctioning bodies; and professional motorsports teams. Applicable to purchases made on or after July 1, 2014, the aggregate annual refund amount allowed to specified nonprofit entities for a fiscal year is limited to \$31.7 million (\$13.3 million limit for aggregate annual local refund).

**Admission charges to an entertainment activity:** Applicable to admissions purchased on or after January 1, 2014, the general sales tax rate of 4.75% applies to admission charges to the following entertainment activities: a live performance or other live event of any kind; a motion picture or film; or a museum, a cultural site, a garden, an exhibit, a show, or a similar attraction



or a guided tour at any of these attractions. Previously, a privilege tax of: 3% applied to live entertainment and ticket resales; and 1% applied to motion picture shows for which an admission was charged. Admission charges to the following entertainment activities are exempt from sales tax: an event that is held at an elementary or secondary school and is sponsored by the school; a commercial agricultural fair; a festival or other recreational or entertainment activity that lasts no more than seven consecutive days and is sponsored by a nonprofit entity that is exempt from income tax and uses the entire proceeds of the activity exclusively for the entity's nonprofit purposes (exemption applies to first two activities sponsored by the entity during a calendar year); a youth athletic contest sponsored by a nonprofit entity that is exempt from income tax; or a state attraction.

**Compromise of liability:** The Secretary of Revenue may compromise a taxpayer's liability for a tax when the Secretary determines that the compromise is in the best interest of the state and makes a finding that the taxpayer is a retailer or a person under the sales and use tax provisions; the assessment is for sales or use tax the retailer failed to collect or the person failed to pay on an item taxable pursuant to admission charges to an entertainment activity or a service contract, and the retailer or person made a good faith effort to comply with the sales and use tax law. Such compromise of a taxpayer's liability expires for assessments issued after July 1, 2020.

**Service contract:** Applicable to sales made on or after January 1, 2014, the general rate of 4.75% applies to the sales price of a service contract. N.C. Gen. Stat. § 105-164.3(38b) defines “[s]ervice contract” as “[a] warranty agreement, a maintenance agreement, a repair contract, or a similar agreement or contract by which the seller agrees to maintain or repair tangible personal property.” N.C. Gen. Stat. § 105-164.3(46) defines “[t]angible personal property” as “[p]ersonal property that may be seen, weighed, measured, felt, or touched or is in any other manner perceptible to the senses. The term includes electricity, water, gas, steam, and prewritten computer software.”

A single repair transaction between a retailer and a purchaser for tangible personal property that is not completed pursuant to a “service contract” sold to a purchaser is not a service contract for purposes of N.C. Gen. Stat. § 105-164.4(a)(11). For example, a retailer that sells and installs an alternator for a motor vehicle, where such transaction is not completed under a service contract, continues to be subject to the 4.75% general State and applicable local and transit rates of sales and use tax on the retail sales price of the alternator. The amount charged by the retailer to the purchaser for installation of the alternator is exempt from sales and use tax per N.C. Gen. Stat. § 105-164.13(49) provided the installation labor is separately stated on the invoice or similar billing document given to the purchaser at the time of sale.

[Read the complete NCDOR bulletin](#) on the service contract changes.