

# Overview of North Carolina's Personal Income Tax

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# NC's Personal Income Tax

- NC Constitutional Amendment of 1920
  - Permitted the taxation of incomes
  - Rate of tax on incomes could not exceed 6%
  - Exemptions so only net incomes taxed
- Amendment of 1935
  - 6% limitation increased to 10%



# Issues re: NC's Personal Income Tax

- Grown to become the largest single source of state revenues
  - Volatility of non-withholding portion of the tax
  - High marginal rate
- Reliance on federal tax code changes
- Primary vehicle for ensuring tax equity in the tax system as a whole



## NC Personal Income Tax Prior to 1989

- NC did not employ a federal starting point for calculating State taxable income
- Numerous exemptions
- Numerous credits
- Five tax brackets
- Rates ranging from 3% to 7%



# Tax Fairness Act of 1989

- Modernized the personal income tax
- Simplified calculation of the tax
- Provided relief to low income taxpayers
  - Reduced taxes for approximately 65% of the taxpayers
  - Increased personal exemption and standard deduction
  - Two tax brackets with rates of 6% and 7%



# Calculating State Taxable Income

**State taxable income =**

Federal taxable income

- Amounts exempt from State income tax
- + Amounts taxed by the State but not by the federal government



# Federal Taxable Income

- Constitutional limitation on delegation of taxing authority
  - IRC Update
- Subjects NC tax revenues to federal tax policies
  - Bonus depreciation
- NC does not index personal exemptions or standard deduction



# State Tax Exemptions: Federal Law

- Interest on US obligations
- Income from an Indian tribe
- Amounts paid under the Railroad Retirement Act of 1937



# State Tax Exemptions: Contractual



- Gain from obligations issued before 1995 to the extent allowed by State law
- Bailey retirement income (\$401.7 m)



# State Tax Exemptions: Practice

- Interest on NC and local government obligations and obligations of a nonprofit educational institution chartered in NC
- The deductible amount for interest on US, NC, and nonprofit educational institutions = \$20.9 m
  - Deductible amount for NC obligations > \$ 1 m



# State Tax Exemptions: Accounting



- Refunds of state, local, and foreign taxes
- Amount by which basis of property under State law differs from the basis of the property under federal law

