

**From:** Maybank, Burnet R. III <BMaybank@nexsenpruet.com>  
**To:** Maybank, Burnet R. IIIBMaybank@nexsenpruet.com  
**Date:** 1/15/2014 4:24:12 PM  
**Subject:** ED & SALT LSS: NC tax overhaul takes effect now

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## N.C. tax overhaul takes effect in 2014

By Gary D. Robertson  
The Associated Press  
© December 28, 2013  
RALEIGH, N.C.

North Carolina state leaders say major tax changes taking effect in 2014 will simplify returns, create jobs and keep more money in people's wallets. Critics say the new rules will diminish funds for schools and widen the gap between haves and have-nots.

The most substantive changes passed this summer by the General Assembly and signed by Gov. Pat McCrory take effect Jan. 1.

Republicans insist the new tax law will help the state to attract new businesses and create jobs by lowering income tax rates that have been the highest among Southeastern states. They've emphasized the new lower flat rate of 5.8 percent for personal income tax — compared to the outgoing three-tiered system of 6, 7 and almost 7.8 percent — and noted more than 40 credits, exemptions and deductions ultimately will expire or be repealed.

"We're trying to clean up and make it simplified and get rid of all of the loopholes, and make sure everyone is treated the same," said Sen. Bob Rucho, R-Mecklenburg, who co-chairs the Senate Finance Committee. "We would rather have everybody enjoy a lower personal income tax rate."

But gone are valuable tax breaks. Owners of many types of businesses lose a deduction on their first \$50,000 of income, while home-related deductions on mortgage interest and property taxes are capped at \$20,000 combined. A credit for child care expenses and deductions on certain kinds of pension income are gone.

Sales taxes are going up on mobile and modular homes and will now be applied to service contracts for appliances and automobiles. Theater chains, arenas and many nonprofit arts groups will have to charge full sales tax on movie and concert tickets and most other live events.

Also set to expire on Jan. 1 is the earned-income tax credit, which gives payments to some of the working poor even if they owe no taxes. The credit's elimination means some low-income families might have to pay a small tax bill again. The corporate tax rate, meanwhile, will decline from 6.9 percent to 6 percent in 2014. Both personal and corporate income tax rates fall further in 2015.

Under the new law, "the people who got the tax breaks were the very wealthy and out-of-state corporations," said Senate Minority Leader Martin Nesbitt, D-Buncombe, while "those who had the earned-income tax credit will get less."

Tax experts say whether an individual taxpayer wins or loses will vary depending on each specific situation.

Like any tax overhaul plan, "there will be winners and losers," Cindy Avrette, with the General Assembly's non-partisan staff, told lawmakers at a December tax policy meeting. But as far as personal income taxes go, she said most people should see an increase in take-home pay.

Regardless, the changes are forcing nearly everyone to adjust: Millions of workers are adjusting their net pay in response to the law's one flat income-tax rate, higher standard deductions and eliminated personal exemptions.

Gerald Townsend, who operates a Raleigh investment advisory firm, said the 2014 income tax rate reduction is “a good savings,” but some high-end taxpayers will lose out on beneficial itemized deductions.

About 650,000 tax returns had been projected to take advantage of the business deduction in 2014, according to legislative researchers.

For many clients, Townsend said, the deduction “basically made your small business tax free.”

Retirees still are able to exempt Social Security income and some government pension payments from state income tax. But other pension income deductions of up to \$4,000 are eliminated. Retiree Mike Dowling of Asheville said he expects it will lead to less disposable income.

“I’m going to probably take a long look at what I give to charities,” said Dowling, who’s also on AARP’s executive council in North Carolina. “It’s going to have some impact on how much I travel for pleasure.”

Determining the benefits or costs of the tax overhaul to North Carolina over time may have more to do with the state’s unemployment rate and money available in the state’s coffers.

Republicans argue the tax changes — projected to result in \$524 million less in combined revenue through mid-2015 compared to if no tax changes were made — will help accelerate the state’s recovery.

They say the state’s high income-tax rates have been a hindrance to job creation, so cutting them will attract more companies to locate or expand in North Carolina. That will lead to a lower unemployment rate and more tax revenues overall from more employed people paying taxes, which then can be used for public education and other priorities, supporters say.

Speaking to a North Carolina Chamber audience earlier this month, McCrory said the state is already competing better against adjoining states such as South Carolina in the quest for jobs. “They no longer have an advantage right over the border in recruiting good manufacturing firms,” the governor said.

But the price tag on the tax package means less money in the short term for raising teacher salaries, health care or other infrastructure needs that attract companies more, said Alexandra Sirota with the liberal-leaning North Carolina Budget & Tax Center. States that cut taxes the most during the 1990s had weak job growth and personal income growth, while similar states with large personal income tax cuts during the past decade saw their economies grow more slowly than the national average, a center report said.

“The facts on the ground tell us that this is not the type of bet that our policymakers should have made in North Carolina,” Sirota said.

Michael Wenig, a tax modernization task force member with the North Carolina Association of Certified Public Accountants, said it’s unclear right now what the overhaul’s result will be for the state at-large.

“We need to see what the economy does,” Wenig said. “Sitting here today, will that work? I have no idea.”

**Burnet R. Maybank, III**

Nexsen Pruet, LLC

1230 Main Street, Suite 700 (29201)

P.O. Drawer 2426

Columbia, SC 29202

T: 803.540.2048, F: 803.253.8277

Cell: 803.960.3024

[bmaybank@nexsenpruet.com](mailto:bmaybank@nexsenpruet.com)

[www.nexsenpruet.com](http://www.nexsenpruet.com)

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