



## **Bill Filed To Replace Franchise Tax with Business Privilege Tax**

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North Carolina's franchise tax has been criticized as complicated and difficult to understand. The taxpayer must make three separate computations in order to determine its franchise tax base. The franchise tax statutes employ unclear language and include many adjustments that give taxpayers difficulty. Also, as the use of other limited liability organizations not subject to the franchise tax has become popular, organizations with similar businesses have confronted different tax burdens. The General Assembly has also allowed the imposition of a variety of local privilege taxes which are archaic and seemingly random in their application.

SB 363, introduced by Senator Andrew Brock on March 19, would repeal most state-level and all local privilege taxes and replace the franchise tax with a simplified business privilege tax. The business privilege tax would apply to corporations as well as business entities with limited liability, including LLCs, LLPs, and other such entities.

The proposed business privilege tax would apply to domestic and foreign corporations and all other business entities whose form of organization confers limited liability on one or more of its owners. Excluded from the tax would be single member LLCs whose single member is a corporation subject to the new tax and whose net worth and property are included in the corporation's tax base. Investment companies such as regulated investment companies, real estate investment trusts other than non-captive REITS, and venture capital companies would have special provisions that would limit the effect of the new tax.

Business entities exempt from federal income tax, certain insurance companies, and real estate mortgage investment conduits would be excluded from the business privilege tax, except to the extent that they have unrelated business income. Exempt business entities that have unrelated business income would be subject to the tax on "adjusted net worth or property attributable to its unrelated business income."

The tax would be imposed at a rate of \$1.35 per \$1000 of the business entity's net worth tax base, with a minimum tax of \$500, a maximum tax of \$5000 on business entities other than corporations, and a maximum tax of \$75,000 on holding companies. Net worth is defined as the entity's total assets less its total liabilities computed in accordance with generally accepted accounting principles at the end of the entity's taxable year, subject to adjustments to conform deductions for depreciation and amortization to the method used for federal tax purposes, an addition for affiliated indebtedness, and a deduction for the cost of treasury stock.

Entities that do not maintain books in accordance with generally accepted accounting principles compute their net worth in accordance with the method that they use for federal tax purposes.

While LLCs controlled by corporations have been subject to the franchise tax for several years, non-corporate controlled LLCs and other non-corporate limited liability entities would be subject to this form of taxation for the first time.

Interestingly, Section 1.(c)(5) of the bill states that it is the intention of the General Assembly to "exempt businesses that pay the franchise tax from the sales tax base expansion to business services." The draft presumably meant to use the term "business privilege tax" rather than "franchise tax." This language may signal sales and use tax legislation to come.

## **Related People**

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