North Carolina's business tax climate

Current conditions and options for change

August 2026

Prepared for the North Carolina Chamber Foundation

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Executive summary

EY was engaged by the North Carolina Chamber Foundation in conjunction with the Council On State Taxation to evaluate North Carolina's business tax climate and identify opportunities for improvement. This report presents the findings of that analysis including an overview of North Carolina's tax structure compared with other benchmark states, a summary of the state's aggregate business tax burden, an analysis of the tax liability that would be due for several types of representative firms in North Carolina and peer states, and a review of potential leading practices which if emulated in North Carolina would improve its competitiveness.[1] Key findings are summarized below.

North Carolina's state & local tax sources

- North Carolina derives 66% of its total state and local tax collections from state sources, compared to 57% in benchmark states and 61% nationwide.
- Among the ten benchmark states in FY2024, North Carolina derived the third largest share of state and local tax revenue from individual income tax, despite significantly reducing the individual income tax rate over the past decade. At the same time, North Carolina's corporate income tax generated 4% of state tax revenues, among the lowest in the benchmark set and well below the US average of 9%.
- Since 2015, sales and use tax collections more than doubled (+109%), while individual income tax collections grew 60% despite significant rate reductions; corporate income tax collections grew 15%, also with significant rate cuts (from 6% to 2.5% from 2014 to 2024, dropping to 2% in 2026). This growth in income tax coincided with significant income tax base expansion that occurred under the Tax Cuts and Jobs Act of 2017, expansion of market-based sourcing, and expanded taxation of foreign-source income. Sales tax growth coincided with base expansion to include various additional taxable services and expanded marketplace facilitator and remote seller taxation, among other base expansions.
- North Carolina's total state and local tax revenue is equal to 8.6% of total aggregate statewide personal income, below the US average of 10.3% and fourth lowest among benchmark states. Similarly, North Carolina's per capita state and local tax was $5,448 compared to $5,965 in the benchmark states and $7,370 nationally in FY2024.

North Carolina overall business taxes

- Businesses pay an estimated 38.9% of North Carolina's state and local taxes collected – the third lowest share among peer states which range from 36% in Michigan to 60% in Texas.
- North Carolina's total state and local business tax revenue is equal to 3.2% of gross state product (GSP), well below the US average of 4.5% and the lowest among all benchmark states, suggesting North Carolina offers an attractive overall business tax climate.
- North Carolina is competitive with the benchmark states across nearly all tax types in terms of aggregate tax collections as a share of economic activity. North Carolina's corporate income taxes equal 0.21% of GSP, 43% lower than the benchmark average and 63% lower than the national average. Property taxes are roughly one-third lower than

[1] Benchmark states are Florida, Georgia, Indiana, Michigan, New Jersey, Ohio, South Carolina, Tennessee, Texas, and Virginia

both benchmark and national averages while sales tax is roughly equivalent to the benchmark states.

- The franchise tax on net worth is a notable outlier feature of North Carolina's tax structure. In North Carolina, the franchise tax is equal to 0.10% of GSP, compared to the benchmark average of 0.03% and five times the national average of 0.02%, suggesting this tax as an area for tax system modernization.

Tax competitiveness for different business types

- While North Carolina's business tax climate is competitive overall, results can vary for businesses with different financial profiles. To evaluate this variation, three representative firms were evaluated: a high-margin mature firm, a low-margin high-volume firm, and a start-up innovator — each with $50 million in net worth but varying profitability.
- The results of this modeling exercise show that for the high-margin firm, North Carolina ranks second lowest in total tax burden among peers, driven by the low corporate income tax rate while for the low-margin, high-volume firm, North Carolina ranks lowest in tax burden (most competitive) due largely to competitive real property taxes.
- For the pre-revenue/loss-making start-up innovator, North Carolina ranks fourth lowest in tax burden (the least favorable ranking of the three firm types), primarily because the franchise tax on net worth disproportionately burdens well-capitalized firms. Without the franchise tax, NC would rank best among peers for this firm type.

Noncompetitive Tax Features & Reform Opportunities

- **Franchise tax on net worth:** State taxes on net worth are decreasing in popularity, evidenced by the repeal of franchise taxes by eleven states in the past 25 years (with only nine states continuing to leverage an uncapped franchise tax on net worth or capital stock). The franchise tax functions as a tax on capital, generates only 1.8% of North Carolina's total state tax revenue, and creates material burdens, especially for innovative, growth-stage businesses. Eliminating the franchise tax would make North Carolina the most competitive tax environment among peer states for well capitalized start-up and growth-stage businesses.

  Sales tax on business inputs: North Carolina's sales tax on business inputs equals 0.96% of GSP, which is in line with the national (0.97%) and benchmark-state (1.04%) averages, reflecting a 7.00% combined state and local average rate similar to peers. However, North Carolina's base is comparatively broad. For example, it applies a narrower modified "direct use" manufacturing exemption test (versus the "integrated plant theory" standard most peer states use, which exempts more indirect production inputs).
- **Tax appeals & administration:** North Carolina earned a "C" on the Council On State Taxation (COST) Scorecard in this category. This is due to the following factors. First, taxpayers must pay the full amount due before appealing an assessment beyond the Office of Administrative Hearings (OAH) to Superior Court — a "pay-to-play" barrier that reduces perceived fairness. Second, OAH judges are not required to have state tax expertise, despite the complexity of business tax cases. Third, North Carolina's 45-day protest period is shorter than the 90-day minimum recommended by the American Bar Association's (ABA) Model State Administrative Tribunal Act.

- **Return filing deadlines & extensions:** North Carolina's corporate return due date matches the federal due date. Because state taxable income is based on federal taxable income, a taxpayer's federal return must be completed before its North Carolina return. Using the same filing date makes it difficult to file an accurate state return. NC also requires a separate state extension form rather than automatically recognizing a federal extension. A 7-month state extension (one month beyond federal) and automatic state extension tied to the federal request would reduce amended filings and eliminate this administrative issue.
- **Reporting federal adjustments (Revenue Agent's Report Rules):** North Carolina lacks a comprehensive definition of "final determination" to clearly trigger federal-change reporting. A desirable approach exists in the Multistate Tax Commission's (MTC) Consensus Model for Reporting Federal Changes Including Partnerships, developed jointly by COST, American Institute for Certified Professional Accountants (AICPA), ABA Tax Section, and others.
- **Mobile Workforce 30-Day safe harbor:** North Carolina currently imposes inconsistent requirements on nonresident employees traveling for temporary business, creating compliance burdens for both employees and employers. Adopting a 30-day safe harbor before nonresident income tax and withholding obligations attach would align NC with the COST Model State Bill and reduce administrative complexity.

While North Carolina's business tax climate is generally competitive, with lower-than-average burdens for most business types, emulating these leading practices would elevate North Carolina to a top-ranked state for both tax competitiveness and taxpayer-friendliness.

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Introduction

EY's Quantitative Economics and Statistics practice in conjunction with the Council On State Taxation was engaged by the North Carolina Chamber Foundation (the Chamber Foundation) to evaluate North Carolina's state and local tax system.

The analysis begins with a comparison of North Carolina's tax system design and burdens to a set of benchmark states, including Florida, Georgia, Indiana, Michigan, New Jersey, Ohio, South Carolina, Tennessee, Texas, and Virginia. The study includes a comparison of tax burdens for several types of representative firms. Based on the results of the analysis and other research, the study then identifies specific leading-practice policy elements which, if emulated in North Carolina, would improve the state's business tax climate.

North Carolina's state and local tax revenue sources

Table 1 below shows North Carolina's major tax revenue sources and collections for FY2024 and their growth over the past ten years. Overall, North Carolina's main sources of state and local tax revenue are individual income taxes, sales and use taxes, and property taxes, which provide 28%, 28%, and 23% of total tax revenue, respectively. Over 72% of **state** tax revenue comes from sales and use and individual income taxes (IIT) while 69% of **local** tax revenue comes from property taxes and 24% from local sales taxes.

Over the prior ten years, North Carolina's state and local sales tax revenue more than doubled and grew more than any other revenue source. Individual income tax revenue grew by 60%, despite significant tax rate reductions, while property and franchise tax revenue grew more modestly at 48% and 35% respectively. While North Carolina's corporate income tax rate has decreased from 6% to 2.5% as of 2024 and 2% as of 2026, its revenue has nonetheless grown 15% over the relevant ten-year period.

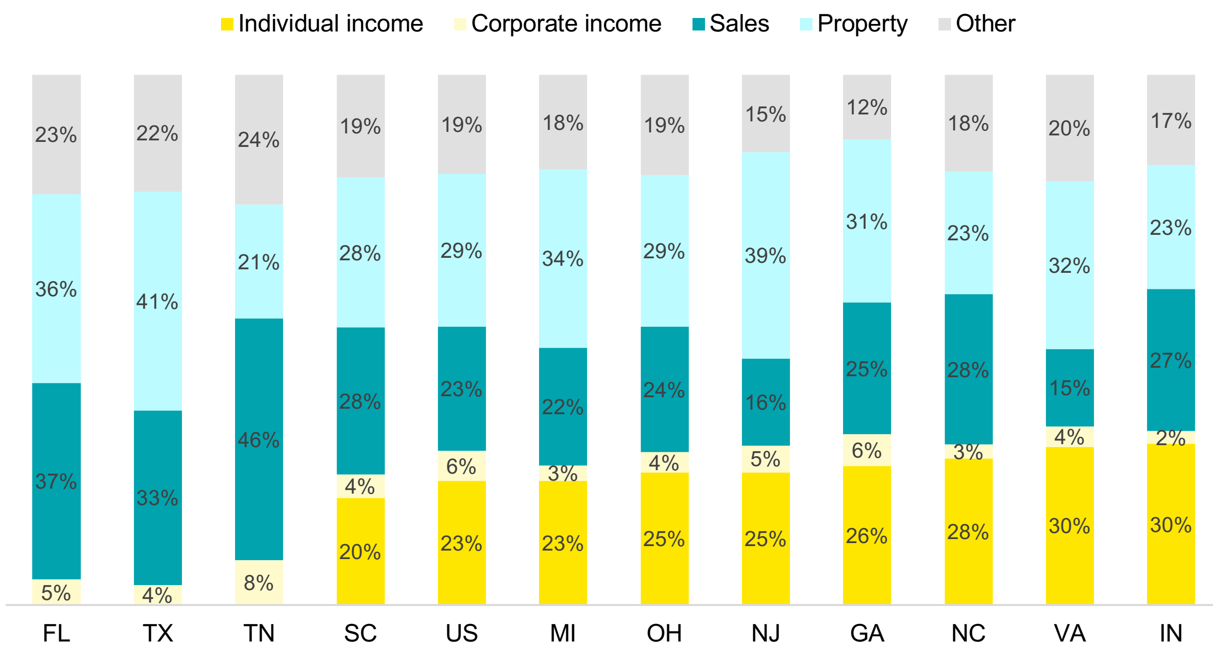
Table 1. State and local tax revenue in North Carolina, FY24 ($billions)

Tax types	FY24	% of total FY24	FY14	10-yr growth	Annual growth rate
Individual income	$16.7	28%	$10.4	60%	4.8%
Sales and use	$17.0	28%	$8.2	109%	7.6%
Property	$14.0	23%	$9.5	48%	4.0%
Corporate income	$1.6	3%	$1.4	15%	1.4%
Franchise tax	$0.7	1%	$0.5	35%	3.0%
Other	$10.2	17%	$8.2	33%	2.9%
Total	**$60.2**	**100%**	**$38.1**	**58%**	**4.7%**

Source: Ernst & Young LLP estimates based on data from the U.S. Census Bureau Annual Survey of State and Local Government Finances. FY24 property tax collections are estimated. Franchise tax collections are based on the NC Department of Revenue annual statistical abstract. Note: amounts may not sum due to rounding

Figure 1 shows the main sources of state and local tax revenue as a share of total collections for all taxes (business and household). State and local taxes are shown together since, for many of the tax types, state vary in their approach to taxing at state and local levels of government. While some states impose only state-level income and sales taxes and distribute a portion to local governments, several of the states included in the peer set and many nationally impose significant local sales and income taxes which are generally economically identical to a state-level tax. To show the overall composition of taxes, Figure 1 includes both levels of government. As compared with the benchmark states levying an individual income tax, North Carolina stands out for its relatively high share of state and local tax revenue from individual income and sales taxes with a low share of corporate income and property taxes.

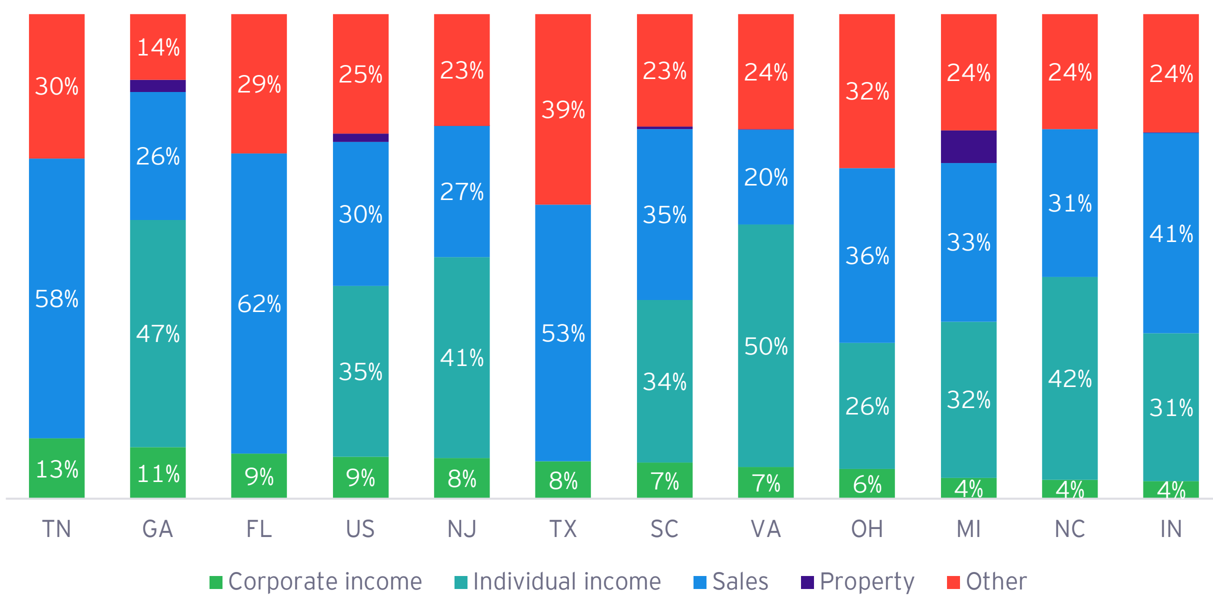
Figure 1. Share of total state and local tax revenue by source, FY2024



Source: Ernst & Young LLP estimates based on data from the U.S. Census Bureau Annual Survey of State and Local Government Finances. FY24 property tax collections are estimated based on U.S. Census data. Note: the "other" tax category includes business and household excise taxes, license fees including franchise taxes on net worth, documentary and stock transfer taxes, and miscellaneous taxes. The corporate income tax category includes gross-receipts-based taxes in Texas and Ohio.

Figure 2 shows composition of state tax revenues. North Carolina derives 66% of its total state and local tax collections from state sources, compared to 57% in benchmark states and 61% nationwide. North Carolina ranks second lowest in terms of share of state tax revenue from corporate income tax and generates the third highest share of revenue from sales tax. Corporate income tax accounts for 4% of North Carolina's state tax revenue, which is less than half the US average of 9%.

Figure 2. Share of total state tax revenue by source, FY2024



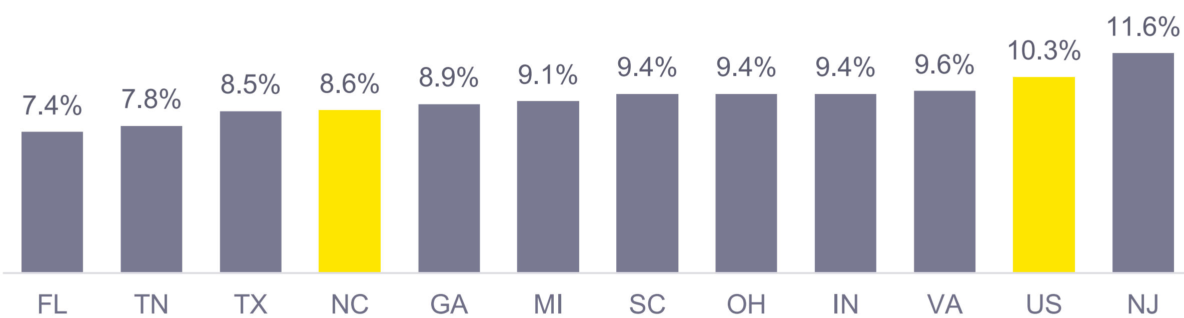
Source: Ernst & Young LLP estimates based on data from the U.S. Census Bureau Annual Survey of State and Local Government Finances. FY24 property tax collections are estimated based on U.S. Census data. Note: the "other" tax category includes business and household excise taxes, license fees including franchise taxes on net worth, documentary and stock transfer taxes, and miscellaneous taxes. The corporate income tax category includes gross-receipts-based taxes in Texas and Ohio.

At the local level, North Carolina has a slightly lower reliance on property tax (69%) than the US average (72%). North Carolina does not generate any local individual income tax in contrast to four of the benchmark states that levy local income taxes in certain cities or statewide.

North Carolina's overall business and household tax burden

North Carolina's combined business and household state and local tax burden is 8.6% of personal income, which is lower than the 10.3% US average as shown in Figure 3. This measure is defined as total state and local tax collections divided by total personal income in the relevant state or nationwide and is the broadest measure of tax burden reflective of the overall level of taxes in a state. The benchmark states generally impose a lower tax burden as a share of personal income than the US average; North Carolina is fourth lowest among the benchmark states in terms of this measure. In fact, of the benchmark states, the only states that impose a lower tax burden as a share of personal income are those with no individual income tax, Florida, Tennessee and Texas. In FY24, North Carolina's total state and local tax per capita was $5,448 compared to $5,965 in the peer states, and $7,370 nationally.

Figure 3. Total state and local taxes as a share of personal income, FY24



Source: Ernst & Young LLP estimates based on data from the U.S. Census Bureau Annual Survey of State and Local Government Finances.

While the share of taxes paid by business in each state is not an indicator of the state's competitiveness, it provides useful information about the structure of a state's tax system and reliance on businesses for revenue generation. Businesses pay an estimated 38.9% of state and local taxes in North Carolina, the third lowest share among benchmark states, which range from 36% in Michigan to 60% in Texas. Table 2 shows the estimated business share in North Carolina, the US, and an average across the benchmark states. Across most tax types, North Carolina businesses pay a slightly lower business share than the benchmark state average, with the exception of property and sales taxes.

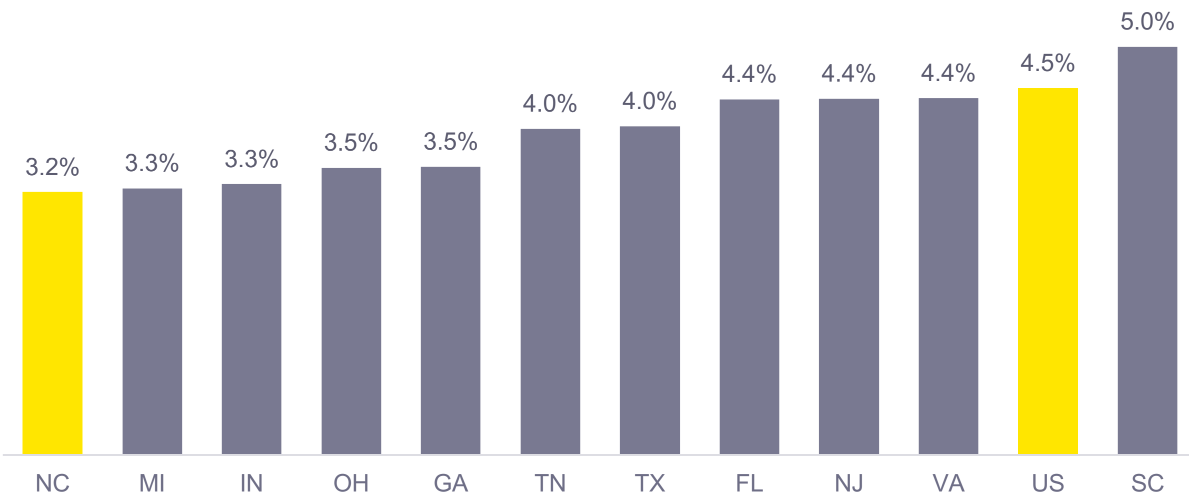
Table 2. Estimated business shares of tax collections in North Carolina, US and peer state average, by tax type, FY24

Tax type	North Carolina	Benchmark states	United States
Corporate income	100.0%	100.0%	100.0%
Property	49.4%	46.1%	54.1%
Sales	41.0%	39.9%	41.8%
Individual income*	12.2%	13.1%	15.8%
Other	54.3%	55.6%	59.1%
Total	**38.9%**	**40.8%**	**45.8%**

*Business share for this category is pass-through income taxes and pass-through entity tax.
Source: Ernst & Young LLP estimates based on data from the U.S. Census Bureau Annual Survey of State and Local Government Finances.
Note: Other taxes include corporate license (franchise),death and gift, documentary and stock transfer and severance taxes.

A more relevant measure of tax burden is the total effective business tax rate (TEBTR), shown in Figure 4. North Carolina's TEBTR, measured as total state and local taxes paid by business as a share of gross state product, is 3.2%, which is well below the US state average of 4.5% and the lowest among the benchmark states, as shown in Figure 4.

Figure 4. Total effective business tax rates, TEBTR FY24



Source: Ernst & Young LLP estimates based on data from the U.S. Census Bureau Annual Survey of State and Local Government Finances and state annual consolidated fiscal reports. See the EY and Council on State Taxation, "Total state and local business taxes: state-by-state estimates for FY24," December 2025.

As shown in Table 3 below, North Carolina's total state and local business tax as a share of gross state product is the lowest of the benchmark states. North Carolina levies corporate income taxes equal to 0.21% of gross state product, 43% lower than the benchmark average of 0.37% and 63% lower than the national average of 0.56%. Real and personal property taxes are roughly one-third lower than the benchmark and national average, while sales taxes on business inputs are approximately in line with both the benchmark and national average.

One area where North Carolina diverges is the franchise tax on net worth – a tax that is absent in most of the benchmark states. Of the other benchmark states, only Georgia, South Carolina, and Tennessee levy franchise taxes on net worth or capital stock, although Georgia's tax is limited to $5,000 per taxpayer annually and does not generate significant revenue for the state. As a result, while North Carolina's franchise tax is equal to 0.10% of gross state product, the benchmark state average is 0.03% and the national average is 0.02%.

Table 3. State and local business taxes as a share of state GSP, by type of tax, FY24							
	Individual income	Corporate income	Franchise /net worth	Sales	Property	Other	Total
South Carolina	0.22%	0.45%	0.06%	1.03%	2.21%	0.95%	4.93%
New Jersey	0.59%	0.62%	0.00%	0.86%	1.16%	1.14%	4.37%
Florida	0.00%	0.40%	0.00%	1.26%	1.66%	1.05%	4.37%
Virginia	0.25%	0.40%	0.00%	0.60%	1.98%	1.11%	4.35%
Texas	0.00%	0.28%	0.00%	1.27%	1.76%	0.99%	4.30%
Tennessee	0.00%	0.62%	0.30%	1.35%	0.92%	0.77%	3.96%
Georgia	0.23%	0.47%	0.01%	0.86%	1.39%	0.59%	3.54%
Ohio	0.18%	0.34%	0.00%	0.83%	1.23%	0.95%	3.53%
Indiana	0.44%	0.21%	0.00%	0.75%	1.33%	0.60%	3.32%
Michigan	0.22%	0.27%	0.00%	0.74%	1.28%	0.78%	3.28%
North Carolina	0.28%	0.21%	0.10%	0.96%	0.95%	0.72%	3.23%
Benchmark avg.	0.16%	0.37%	0.03%	1.04%	1.49%	0.92%	4.00%
United States	0.37%	0.56%	0.02%	0.97%	1.54%	1.07%	4.53%

Source: Ernst & Young LLP estimates based on data from the U.S. Census Bureau Annual Survey of State and Local Government Finances and state annual consolidated fiscal reports. See the EY and Council On State Taxation, "Total state and local business taxes: state-by-state estimates for FY24," December 2025. Note: amounts may not sum due to rounding.

Assessing North Carolina's tax competitiveness for different types of businesses

To further understand the competitiveness of North Carolina's tax system, taxes were estimated for representative businesses with different asset and profitability profiles. The analysis constructs an operations profile for hypothetical businesses of three types: a high-margin mature business, a start-up innovation business, and a low-margin volume business. These profiles were developed to illustrate the difference in tax climate for firms of different types and specifically the role that indirect or asset-based taxes play in the business tax system.

For firms with low or no net income, taxes on assets and other indirect taxes can impose a greater burden relative to profitability and the ability to pay. These businesses include pre- or low-revenue start-ups with significant acquired capital and investment, as well as more mature businesses experiencing a downturn in profitability or revenue.

Table 4 shows the financial profile for the three representative firms used in the business tax analysis presented in this section based on IRS Statistics of Income data for proxy industries. These financial profiles are set to the same $50 million in net worth with varying levels of capital stock, depreciable assets, business receipts, cost of goods sold, other deductions, and net income. The IRS data for these proxy sectors imply significant differences in the return on equity and profit margin on receipts which are important in determining how each firm interacts with the state tax systems.

Table 4. Financial profiles for representative firms ($000s)

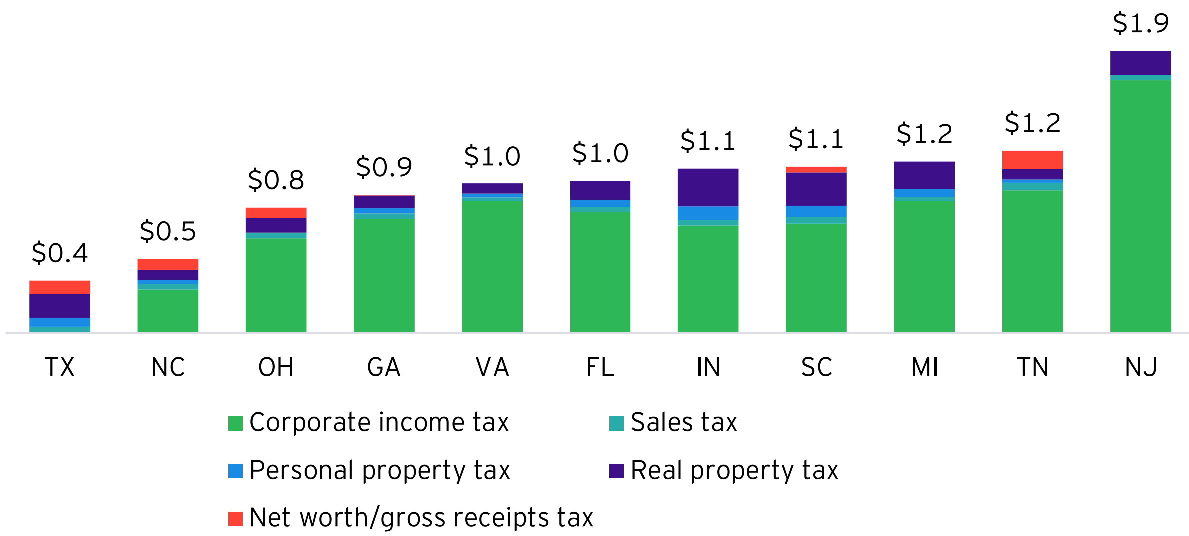
	High margin mature firm	Start-up innovator	Low-margin mature firm
Net worth, total	$50,000	$50,000	$50,000
Capital stock	5,535	10,075	1,126
Additional paid-in capital	32,340	107,723	14,568
Total assets	112,726	144,024	90,007
Depreciable assets	$9,986	$17,261	$19,458
Business receipts	27,309	37,312	60,064
Other deductions	3,606	9,495	3,710
Cost of goods sold	15,251	23,970	47,609
Net income	14,853	(13,016)	2,968
Return on equity	30%	-26%	6%
Profit margin	54%	-35%	5%

Source: Ernst and Young LLP based on IRS Statistics of Income, U.S. Economic Census and U.S. Bureau of Economic Analysis data. High-margin firm is based on positive net income pharmaceutical corporate taxpayers, the start up innovator is based on no net income pharmaceutical companies, and the low-margin mature firm is based on the food wholesale industry.

North Carolina is generally competitive for all business types, due in part to North Carolina's low corporate income tax rate and low real property taxes. In our analysis, North Carolina is between the lowest and the fourth lowest of the benchmark states for three representative firms.

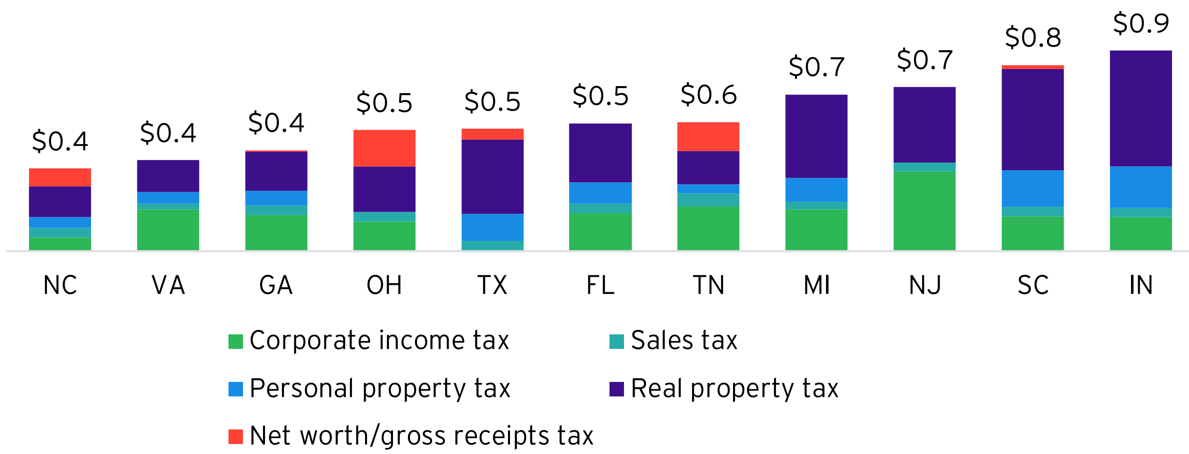
For the high-margin, profitable firm, such as a mature pharmaceutical company North Carolina ranks second lowest due to its very competitive corporate income tax as shown in Figure 5. (See Appendix for comparison of statutory tax rates and other tax features.) While North Carolina's other taxes are also competitive, given the high profitability of this representative firm, the corporate income tax is the driver of the ranking. Only Texas, with a modified gross receipts tax in lieu of a corporate income tax, imposes a lower overall tax burden on this firm. Only three of the benchmark states (including North Carolina) impose a substantial tax on capital stock or net worth.

Figure 5. Annual taxes for mature high-margin firm with $50 million net worth ($000s)



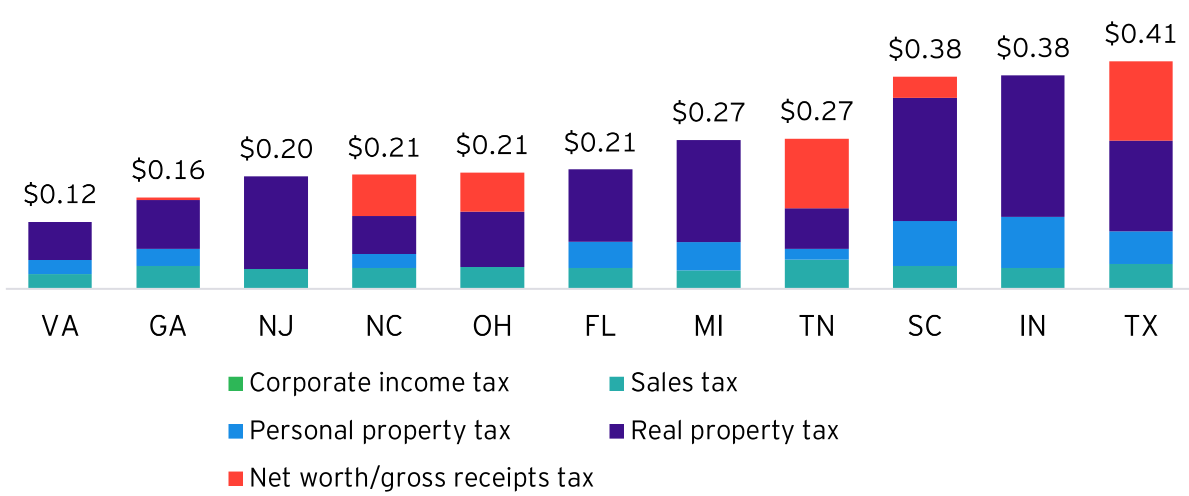
For the high-volume, low-margin firm, such as a food wholesaler, North Carolina ranks lowest due to its competitive property tax and very competitive corporate income tax as shown in Figure 6. (See Appendix for comparison of statutory tax rates and other tax features.) While North Carolina's other taxes are also competitive, given the lower profitability of this representative firm, indirect taxes are the driver of the ranking. In several of the benchmark states with higher property tax rates, property tax is the driver of the ranking. And despite North Carolina's franchise tax which is not levied in several of the benchmark states, North Carolina still ranks lowest in terms of tax burden.

Figure 6. Annual tax for mature, high volume, low margin firm with $50 million net worth ($000s)



For the start-up innovator firm, such as a young biotech firm, North Carolina has the least favorable ranking of all the representative firms due in part to the franchise tax, as shown in Figure 7. This representative firm is well capitalized, leading to a substantial franchise tax on net worth. While North Carolina's other tax features mitigate the impact of this tax to produce a ranking of fourth-best among the benchmark states, in the absence of the franchise tax, North Carolina would have ranked best among peers. Georgia, North Carolina, Tennessee, and South Carolina impose some form of net worth or capital stock tax, while Ohio and Texas impose taxes on gross receipts or modified gross receipts.

Figure 7. Annual taxes for start-up innovator with net loss, negative income with $50 million net worth ($000s)



Overall, North Carolina offers an attractive business tax climate as measured in terms of aggregate tax liability as a share of gross state product and in terms of tax burden for representative firms. The combination of North Carolina's competitive tax rates for corporate income, and property taxes, with a moderate sales tax rate are enough to provide a low-tax environment for business investment.

Potential areas of improvement for North Carolina's tax system

North Carolina's tax system offers a generally competitive tax environment for businesses, but there is room for improvement.

North Carolina's franchise tax

Taxes on net worth are one of the oldest forms of taxation, pre-dating modern corporate income taxes. State franchise taxes on net worth or capital stock are generally imposed independently of corporate income tax. The net worth tax base is generally defined as the book value of a corporation's assets less its liabilities equivalent to the sum of issued capital stock, paid-in or capital surplus, and retained earnings. Capital stock taxes are similar but distinct taxes that apply to generally a narrower base of the par or stated value of issued shares. This means that net worth is the broader tax base that also includes equity of the enterprise, including accumulated earnings and, in some states, adjustments for treasury stock, indebtedness, or apportioned property.

Despite their long existence, franchise taxes on net worth reduce competitiveness for new business investment, have only an indirect relation to a taxpayer's ability to pay, and create additional compliance responsibility. Most importantly, the franchise tax functions as an additional tax on capital investment in North Carolina. Economies expand through the accumulation of physical and financial capital, human capital, and technological progress. As such, levying a tax on capital is akin to taxing job creation or innovation in terms of effects on economic growth, with effects that are potentially longer lasting given the timeline for capital accumulation. For these reasons, most states, including most of the benchmark states, have eliminated their franchise taxes, as shown in Table 5.

Table 5. State net worth and capital stock tax repeals over the past 25 years

State	Year of elimination	Commentary
Ohio	2010	Replaced corporate franchise tax (which included a net worth component) with the Commercial Activity Tax (CAT) under HB 66 in 2005; the franchise tax was fully phased out by 2010.
Kansas	2011	Completely phased out its capital stock (franchise) tax prior to tax year 2011.
West Virginia	2015	Repealed its business franchise tax (based on capital/net worth) effective for tax years beginning after 2014.
Rhode Island	2015	Repealed its capital stock tax as part of broader tax reform.
Pennsylvania	2016	After years of phased rate reductions beginning around 2000, the capital stock and foreign franchise tax was finally repealed effective January 1, 2016.
Missouri	2016	Eliminated its corporate franchise tax effective 2016.
New York	2021	Completed a phaseout of its capital base (net worth) tax component under the corporate franchise tax as of January 1, 2021. However, due to COVID-19 budget concerns, the state temporarily reinstated a capital base tax for large corporations (those with business capital over $39 million) for tax years 2021–2023; the surcharge expired at the end of 2023.
Connecticut	2024	Phased out its capital stock (business entity) tax, completing the process by 2024.
Oklahoma	2024	Phased out its franchise (capital stock) tax, with full repeal taking effect in 2024.
Illinois	2024	Illinois phased out its franchise tax (levied on paid-in capital) with full elimination by 2024, though the path was not smooth — the state initially planned to exempt all capital stock from taxation, reversed course, and then ultimately completed the phaseout.
Louisiana	2026	Louisiana officially repealed its corporation franchise tax for all tax periods beginning on or after January 1, 2026
Mississippi	2028 (in process)	Legislation enacted to phase out the franchise (capital stock) tax, with complete elimination expected by 2028. Rates are being phased down incrementally.

In 2026, nine states impose unlimited taxes on net worth or capital stock – a number which has been declining rapidly over the past 25 years.[2] Recognizing the challenges inherent in taxing net worth, 11 have repealed their franchise taxes during that time, with Mississippi currently phasing out its tax over several years. In North Carolina, the franchise tax generates 1.8% of total state tax revenue but creates material tax burdens for certain types of businesses, including innovative businesses in a growth phase with low or no revenue as they develop new products. In the absence of the franchise tax, North Carolina would be the most competitive tax environment among peer states for these types of growth investments.

In addition to the economic burden of the tax and the basic reporting requirements, franchise taxes often introduce additional reporting complications which arise most acutely under separate entity taxation regimes, where each legal entity in a corporate family files its own return and computes its own net worth base rather than reporting on a consolidated or combined basis. In a typical multi-tier corporate structure where several layers of entities with ownership of lower-level entities may exist, the same net worth may be taxed multiple times, once at each level of the corporate family tree. Absent a statutory investment-in-subsidiary deduction, an intercompany elimination, or a combined/consolidated filing election, states can effectively tax the same dollar of equity multiple times.

Even where states offer relief, taxpayers face significant compliance burdens in identifying qualifying subsidiaries, tracing investment accounts through reorganizations and subsidiary entity accounting, reconciling GAAP book values with tax-basis balance sheets and coordinating apportionment factors that may differ from those used for income tax purposes.

North Carolina's business input sales tax

North Carolina's sales tax on business inputs as a share of economic activity measured by GSP is 0.96%, compared to 0.97% in the United States and 1.04% in the benchmark states. This result arises from an average combined state and local sales tax rate of 7.00%, which is similar to the benchmark average sales tax rate of 7.12% and the US average sales tax rate of 6.74% (including states with no sales tax). Note, however, that local sales tax rates vary across North Carolina.

One area of North Carolina's sales tax structure that varies from several of the benchmark states is the taxation, generally, of manufacturing inputs that do not meet the direct use test. For manufacturers, states apply varying standards when determining whether a business purchase qualifies as exempt under the state's manufacturing exemption. While the standards are detailed and few states apply exactly the same rule, they can be classified generally as "integrated plant theory" states and "direct use" states. In an integrated-plant-theory state, the test for exemption is whether a purchase forms part of the integrated production process of a manufactured good, which generally includes production stages such as material handling and packaging. This broad exemption also generally exempts purchases of electricity and utilities used in the manufacturing process and other "indirect" supplies that form part of the integrated production process but may not be directly used in the production of the good.

[2] Note that several other states impose net worth or capital stock taxes with relatively low dollar limits, such as Georgia's tax with a $5,000 limit or Oklahoma's $20,000 limit.

In contrast, states that apply a direct use test limits the manufacturing sales tax exemption to machinery, equipment, and supplies that are used directly in the production process, meaning they must have an immediate physical or chemical effect on the product being manufactured, rather than merely supporting or being incidental to production activities. In direct-use states, "indirect" manufacturing purchases are subject to sales tax.

If North Carolina defined exempt manufacturing property as all machinery, equipment, supplies, and utilities that are part of an integrated manufacturing process from the receipt of raw materials through packaging and preparation for shipment, the tax environment for manufacturers would be materially improved. Such a change would expand the exemption beyond the current direct-use standard to include production-support functions, material handling systems, certain indirect consumables, and other equipment necessary to the integrated operation of a manufacturing facility. This treatment of manufacturing inputs would reduce taxation of business inputs, align North Carolina more closely with states that provide broader manufacturing exemptions, and eliminate sales tax on a wider range of production-related purchases.

Opportunities to improve North Carolina's system of tax appeals and administration

The Council On State Taxation (COST) has long monitored and commented on state tax appeals processes and administrative practices, with a focus on fostering state adoption of procedural rules that enhance the fundamental fairness of state tax administration and appeals. These factors are important because although state tax compliance is subject to audit scrutiny, the percentage of taxpayers actually audited is small. As a result, state (and federal) tax systems are premised, to a great degree, on voluntary compliance. Taxpayers will more fully and willingly comply with a tax system they perceive to be balanced, fair, and effective. In the latest version of the COST Administrative Scorecard (December 2023)[3], North Carolina earned a "C" grade. Although the ranking reflects a system that is functional, the State is not yet fully aligned with leading practices for fair, efficient, and competitive tax administration. Emulating the following leading practices would improve the State's business tax system from a tax administration and tax appeals standpoint.

[3] Council On State Taxation, *The Best and Worst of State Tax Administration: COST Scorecard on Tax Appeals & Administrative Procedures* (Dec. 2023), available at https://www.cost.org/globalassets/cost/state-tax-resources-pdf-pages/cost-studies-articles-reports/cost-2023-admin-scorecard---final-draft-combined.pdf.

State tax appeals payment requirements, tax expertise, and protest period

North Carolina uses the Office of Administrative Hearings (OAH) as its independent forum for state tax appeals.[4] That is a positive feature: OAH is structurally independent from the Department of Revenue (DOR) and appeals from DOR determinations can be heard there without prepayment of the disputed liability. However, to appeal beyond OAH to Superior Court (typically the Business Court, a special division of the Superior Court), a taxpayer must first pay the full amount of tax, penalties, and interest due under the OAH final decision.[5] Although the system does not require payment of tax before an initial review, it still requires taxpayers to surrender 'property' before obtaining a full independent review, including subsequent appeals. The prepayment requirement creates a significant structural disadvantage for taxpayers. Many taxpayers lack the resources to both pay the tax in dispute and fund litigation beyond OAH. Absent a true "jeopardy" situation where collection is genuinely at risk, leading tax administration approaches do not require taxpayers to pay a contested tax until all appeals have expired.

OAH judges are not required by statute to have state-tax expertise, even though many state tax cases are complex and highly technical. Complex state business tax issues, including unitary versus separate reporting, sourcing questions, alternative apportionment, and federal conformity questions, require decision makers with a nuanced understanding of the technical and economic context. Requiring tax expertise of arbiters in the independent forum improves the quality and consistency of decisions, reduces litigation and re-litigation of similar issues, reduces the ALJ's natural tendency to rely on the DOR's perceived expertise, and builds a body of coherent precedent that both taxpayers and DOR can rely on.

Once a taxpayer in North Carolina receives an assessment notice or denial of a refund claim, that taxpayer has 45 days to protest the DOR's action and request an appeal. The American Bar Association's *Model State Administrative Tribunal Act*[6] recommends a minimum 90-day protest period in today's multistate environment, where taxpayers are struggling to comply in numerous taxing jurisdictions. Extending the State's 45-day protest period to 90 days would align North Carolina with the ABA's recommendation and would not impact the State fisc if market interest rates are used to compensate for the lost time value of money.

Return filing deadlines and automatic extensions

North Carolina's original corporate income tax return due date matches the federal due date (15th day of the 4th month after year end). The extended State due date is also aligned with the six-month federal extension, and taxpayers must request a State extension on Form CD-419; a federal extension does not automatically extend the NC due date. These rules create two problems for corporate taxpayers. First, the North Carolina return is due at essentially the same time as the federal return. Because the State return largely flows from

[4] N.C. Gen. Stat. § 105-241.15.
[5] N.C. Gen. Stat. § 105-241.16.
[6] American Bar Association, *Model State Administrative Tax Tribunal Act* (Aug. 2006), available at https://documents.ncsl.org/wwwncsl/Task-Forces/SALT/Model-State-Administrative-Tax-Tribunal-Act.pdf.

settled federal return numbers, if the federal return is not filed until the due date it leaves no time to file an accurate State return, forcing state taxpayers to file on estimated data and then amending at a later date. To resolve this conflict, many states grant an extra month for the state extension, or seven months past the original due date. Second, it makes little sense to require a separate state form requesting a state extension if taxpayers have received a federal extension. Attachment of the federal extension request to the State return should suffice as permission to file an extended State return. Neither of these changes would affect the state fisc, since payment of all state and federal taxes would still be due by the original due dates of these returns. Taken together, the seven-month State extension would result in more accurate State returns (and thus fewer amended filings), and an automatic State extension request tied to the taxpayer's federal request would remove an administrative trap for unwary taxpayers. Both would save administrative resources for taxpayers and the DOR.

Reporting federal adjustments: modernize North Carolina's Revenue Agent's Report rules and adopt the Multistate Tax Commission consensus model

Large multistate businesses are often required to file hundreds, if not thousands, of amended returns at the state and local level when a federal audit tax change (also known as a Revenue Agent's Report or RAR) is made by the taxpayer or the Internal Revenue Service. Compliance with these burdensome reporting requirements is best achieved when state governments adopt uniform and even-handed rules for reporting federal changes to the states that are consistent regardless of whether the change results in a refund claim or an assessment. North Carolina has adopted many uniform procedures in this area, including adequate time and scope limitations, but is lacking a few procedural items that are easily enacted through statutory change. These include a comprehensive definition of "final determination" that clearly advises taxpayers and the State when all litigation and pending appeals are concluded and thus triggers the reporting requirement, and adoption of the Multistate Tax Commission's Consensus Model for Reporting Federal Changes including Partnerships.[7] The MTC Model was developed in conjunction with COST, the AICPA, the ABA Tax Section, and other interested parties and addresses new rules the IRS is currently implementing in audits of large partnerships. The Consensus Model also includes recommendations for reporting federal audit changes for all taxpayers, whether organized as a C-corporation or a partnership, including a recommended definition of "final determination."

Mobile workforce 30-day safe harbor for taxing nonresident employee income

Many states, including North Carolina, currently impose inconsistent, varying standards and requirements for: 1) employees required to file personal income tax returns when traveling for business purposes and temporary periods to a nonresident state, and 2) employers seeking to properly withhold on an employee's income when that employee travels to a nonresident state. Employees who travel outside of their state of residence for business purposes are subject to onerous administrative burdens because they may be legally required to file an income tax return in every other state into which they travel for work, in many

[7] The entire MTC Model, including the partnership audit provisions, adopted January 2019, is available at https://www.mtc.gov/wp-content/uploads/MTCImages&Files/MTC/media/AUR/Proposed-Model-RAR-StatuteTechnical-Corrections-10-25-20.pdf. The MTC Model was developed in collaboration with several taxpayer groups including COST, AICPA, the ABA Tax Section, TEI, and IPT.

states even if for only one day. Employers incur extraordinary expenses in their efforts to comply with the states' widely divergent withholding requirements for employee travel to non-resident states for temporary work periods. And in some cases, legal requirements for employees and employers differ. Because of the difficulty in tracking and complying with these laws, few statutes are enforced, and if so, only on a selective basis against specific taxpayers and their employees. The patchwork of complexity can be significantly reduced, however, if states each adopt a minimum 30-day safe harbor for nonresident employees traveling for business in their state before personal income tax liability and withholding rules attach. (During that 30-day period, employees and employers would continue to pay and withhold in the employee's resident state.) Congress has considered such a solution for five consecutive sessions, but without enactment. As a result, several states have stepped forward and enacted the COST Model State Bill for a 30-Day Safe Harbor for the Mobile Workforce,[8] based on language in the proposed federal statute.

Conclusion

The North Carolina tax system provides a generally competitive business tax environment that promotes business investment and economic growth. For most business types, North Carolina's tax structure results in a lower tax burden than these businesses would face in other benchmark states or compared to the national average.

While the North Carolina business tax structure is generally competitive in terms of overall tax burden, it deviates from leading practices in several areas, which limit North Carolina's ability to be a top-ranked state in terms of tax liabilities and taxpayer friendliness:

1. The franchise tax: the clear reform trend over the past 25 years has been to eliminate or greatly limit taxes on net worth or capital stock. North Carolina's franchise tax limits its competitiveness and is an outlier compared with most other benchmark states.
2. Sales tax on business inputs: North Carolina imposes a stricter test for manufacturing input exemptions than many of the benchmark states.
3. North Carolina's system of tax appeals and administration lacks leading practice administrative elements:
    1. Appeals: No pay-to-play for judicial review, requisite tax expertise in the independent forum, and a 90-day protest period.
    2. Corporate filing timelines: State due dates that trail federal by at least a month and truly automatic State extensions tied to the federal extension.
    3. Modern, symmetric federal-change reporting: Clear and consistent definition of "final determination" that triggers reporting requirements.
    4. A practical mobile-workforce safe harbor: 30 days before nonresident employees and their employers face North Carolina tax obligations.

By addressing these non-competitive tax system features, North Carolina would provide a more competitive tax environment across firms with varying levels of profitability as well as increase procedural fairness, administrative efficiency, and competitiveness – the elements that most directly influence voluntary compliance and the State's overall business tax climate.

[8] Council On State Taxation, *Model Legislation for a 30-Day Safe Harbor for Nonresident Employees and Their Employers*, available at https://www.cost.org/state-tax-resources/30-Day-Safe-Harbor-for-Traveling-Employees/.

Appendix: Business tax parameters for North Carolina and peer states

Figure A. Tax system parameters for North Carolina and peer states (2026)

	NC	Peer avg		FL	GA	IN	MI	NJ	OH	SC	TN	TX	VA
Corporate income tax													
Corp income tax rate	2.00%	5.49%		5.50%	5.19%	4.90%	6.00%	11.50%	4.31%	5.00%	6.50%	0.00%	6.00%
Sales factor weight	100%	95%		100%	100%	100%	100%	100%	100%	100%	100%	100%	50%
Franchise tax													
Tax base	Net worth			-	Net Worth	-	-	-	-	Cap Stock	Net Worth	-	-
Tax rate	0.15%	0.04%		-	Fixed	-	-	-	-	0.10%	0.25%	-	-
Maximum tax liability	No max			-	5,000	-	-	-	-	No max	No max	-	-
Sales tax													
Sales tax (S&L average)	7.00%	7.12%		6.98%	7.49%	7.00%	6.00%	6.60%	7.09%	7.49%	9.61%	8.20%	4.77%
Property tax													
Personal property tax	0.98%	1.63%		1.88%	1.26%	3.68%	2.07%	0.00%	0.00%	3.23%	0.79%	2.36%	1.01%
Real property tax	0.89%	1.89%		1.69%	1.14%	3.32%	2.40%	2.17%	1.30%	2.91%	0.95%	2.12%	0.91%