



# SENATE BILL 105: 2021 Appropriations Act, Sec. 42.1: Personal Income Tax Reduction

2021-2022 General Assembly

<b>Committee:</b>		<b>Date:</b>	January 26, 2022
<b>Introduced by:</b>		<b>Prepared by:</b>	Finance Team
<b>Analysis of:</b>	Sec. 42.1 of S.L. 2021-180		

**OVERVIEW:** Section 42.1 of S.L. 2021-180 makes the following personal income tax changes:

- Reduces the personal income tax rate to 3.99% over 6 years.
- Increases the standard deduction by approximately 18.6%.
- Increases the child deduction by \$500 and expands eligibility.
- Conforms to the permanent federal medical expense deduction threshold.<sup>1</sup>

These changes are effective for taxable years beginning on or after January 1, 2022.

## CURRENT LAW, BILL ANALYSIS, AND EFFECTIVE DATES:

PERSONAL INCOME TAX CHANGES <sup>2</sup>	
Description	Effective Date
<p><b><u>PIT Rate Reduction</u></b></p> <p>Reduces the individual income tax rate from 5.25% to 3.99% over a period of 6 years as follows:</p> <ul style="list-style-type: none"> <li>2022: 4.99%</li> <li>2023: 4.75%</li> <li>2024: 4.6%</li> <li>2025: 4.5%</li> <li>2026: 4.25%</li> <li>2027 and thereafter: 3.99%</li> </ul> <p>North Carolina moved to a flat tax rate system in 2014. Prior to that date, the State used a tiered tax rate system ranging from 6% to 7.75%. The rate in 2014 was 5.8%. The rate has gradually decreased over time to 5.25%, where it stands today.</p>	<p>For taxable years beginning on or after January 1, 2022</p>

<sup>1</sup> This provision is discussed in both this summary and the summary for Section 42.4 of S.L. 2021-180.

<sup>2</sup> Conformity to the permanent federal medical expense deduction threshold is discussed in the IRC Update section, beginning on page 5 of this Bill Analysis.

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<p><b><u>Increase Standard Deduction</u></b></p> <p>Increases the standard deduction amounts as listed below,<sup>3</sup> resulting in an increase of approximately 18.6%:</p> <ul style="list-style-type: none"> <li>• Married filing jointly: \$21,500 to \$25,500</li> <li>• Married filing separately: \$10,750 to \$12,750</li> <li>• Head of Household: \$16,125 to \$19,125</li> <li>• Single: \$10,750 to \$12,750</li> </ul>	<p>For taxable years beginning on or after January 1, 2022</p>																
<p><b><u>Increase &amp; Expand Child Deduction</u></b></p> <p>Increases the child deduction amount by \$500 and expands eligibility for the credit.</p> <p>North Carolina provides a child deduction of up to \$2,500 per child for a taxpayer who is allowed a federal child tax credit under section 24 of the Code.<sup>4</sup> The deduction amount is based upon the AGI and filing status of the taxpayer. The deduction amount is currently \$0 for taxpayers, married filing jointly, whose AGI is over \$120,000. This section increases the <u>maximum</u> deduction amount to \$3,000 per child, and it expands the number of taxpayers who could benefit from the deduction by increasing the AGI limit for married filing jointly to \$140,000. For married filing jointly, the deduction amounts and AGI brackets are as follows:</p> <table border="0" style="margin-left: auto; margin-right: auto;"> <thead> <tr> <th style="text-align: center;"><u>AGI</u></th> <th style="text-align: center;"><u>Deduction Amount</u></th> </tr> </thead> <tbody> <tr> <td style="text-align: center;">Up to \$40,000</td> <td style="text-align: center;">\$3,000</td> </tr> <tr> <td style="text-align: center;">Over \$40,000 – Up to \$60,000</td> <td style="text-align: center;">\$2,500</td> </tr> <tr> <td style="text-align: center;">Over \$60,000 – Up to \$80,000</td> <td style="text-align: center;">\$2,000</td> </tr> <tr> <td style="text-align: center;">Over \$80,000 – Up to \$100,000</td> <td style="text-align: center;">\$1,500</td> </tr> <tr> <td style="text-align: center;">Over \$100,000 – Up to \$120,000</td> <td style="text-align: center;">\$1,000</td> </tr> <tr> <td style="text-align: center;">Over \$120,000 – Up to \$140,000</td> <td style="text-align: center;">\$500</td> </tr> <tr> <td style="text-align: center;">Over \$140,000</td> <td style="text-align: center;">0</td> </tr> </tbody> </table>	<u>AGI</u>	<u>Deduction Amount</u>	Up to \$40,000	\$3,000	Over \$40,000 – Up to \$60,000	\$2,500	Over \$60,000 – Up to \$80,000	\$2,000	Over \$80,000 – Up to \$100,000	\$1,500	Over \$100,000 – Up to \$120,000	\$1,000	Over \$120,000 – Up to \$140,000	\$500	Over \$140,000	0	<p>For taxable years beginning on or after January 1, 2022</p>
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<p><b><u>Conform to Permanent Federal Medical Expense Deduction Threshold</u></b></p> <p>This change is effectuated through the update of the IRC reference date, which is found in Section 42.4 of this act. However, since the change</p>	<p>Effective July 1, 2021, when the act became law.</p>																

<sup>3</sup> The federal standard deduction amounts for 2022 are slightly higher than these amounts and are indexed annually: \$25,900 (MFJ); \$19,400 (HoH); \$12,950 (S/MFS). The provision in this Part does not provide for annual indexing.

<sup>4</sup> To qualify for the federal credit, a child must be under the age of 17 and meet certain other tests, such as dependency and residency requirements.

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could affect a taxpayer's personal income tax liability, it is described in the analysis of this section as well as in the analysis of Section 42.4.

By updating the IRC reference date in Section 42.4, North Carolina conforms to the permanent lowering of the threshold for taking the federal medical expense deduction from 10% of AGI to 7.5%. This deduction allows a taxpayer to deduct unreimbursed medical expenses that exceed 7.5% of the taxpayer's AGI. The "floor" for the medical expense deductions has fluctuated during recent years between 7.5% and 10%. The floor was scheduled to return to 10% for the 2021 taxable year. The Consolidated Appropriations Act, 2021, enacted on December 27, 2020, made the 7.5% floor permanent.