

HOUSE RESEARCH

Bill Summary

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Authors: Harder and others

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Analyst: Joel Michael, 651-296-5057

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Overview

This bill adopts federal S corporation rules for banks. S corporations are taxed essentially like partnerships. No tax is applied at the corporate level. The corporation's income or losses are attributed to (or pass through) its shareholders and the tax applies at the shareholder level. Present Minnesota law prohibits financial institutions from qualifying for S corporation status. Corporations electing this status under federal law continue to be subject to Minnesota taxation in the same manner as C corporations. That is, the corporation's profits are taxed to the corporation under the corporate franchise tax and any dividends distributed to shareholders are taxed to the shareholders under the individual income tax. This bill would reverse that. Banks that qualify as S corporations under the federal income tax would also be taxed as S corporations under Minnesota law.

- 1 Additions to federal taxable income (FTI).** Eliminates the additions to FTI for S corporation banks. These additions include (1) pass through losses or expenses (under present Minnesota law these are allowed at the corporate level as for a C corporation); (2) actual distributions of property or cash from the S corporation bank, and (3) differences in basis (when the Minnesota tax basis is lower than federal), if shares in the S corporation bank are sold.
- 2 Subtractions from federal taxable income.** Eliminates the subtractions to FTI for S corporation banks. These include (1) pass through income or gain from the S Corporation bank (under present Minnesota law these are taxed at the corporate level as for a C corporation), (2) differences in basis (when the Minnesota tax basis is higher than federal), if shares are sold, and (3) the special deduction for additional distributions made equal to federal tax liability.
- 3 Basis modifications.** Eliminates the basis adjustment for S corporation banks. This basis adjustment provides the individual taxpayer's basis is to be computed as if the S corporation bank were a C corporation.
- 4 Nonresidents and part year residents.** Eliminates the adjustments to calculating the Minnesota percentage used to apportion the tax liability of part year residents and non-residents. Under present law, the numerator is determined without regard to the portions of FTI that are

attributable to S corporation banks and the denominator includes the additions and subtractions to FTI.

- 5 **AMT.** Eliminates the adjustments to alternative minimum taxable income for S corporation distributions. These parallel the additions and subtractions to FTI (except no subtraction is allowed for the distributions equal to federal tax liability on the distributions).
- 6 **AMT credit.** Eliminates the adjustments for S Corporation bank distributions and items in calculation of the credit based on prior year's AMT.
- 7 **S corporation status.** Eliminates the prohibition on banks electing to be S corporations for Minnesota income tax purposes. Any corporation that validly elects S corporation status for federal purposes would also be an S corporation for state purposes. This means, generally, that no corporate level tax would apply. Rather, the corporation's income or losses would flow through to the shareholders.
- 8 **Effective date.** Provides the changes are effective for tax year 1999.