GENERAL ASSEMBLY OF NORTH CAROLINA

Session 2007

Legislative Fiscal Note

REVISED

BILL NUMBER: House Bill 558 (First Edition)

SHORT TITLE: Deduction for S Corporation Income.

SPONSOR(S): Representative Holloway

FISCAL IMPACT

	Yes ( )	No ( )	No Estimate Available ( )		
	FY 2007-08	**FY 2008-09**	**FY 2009-10**	**FY 2010-11**	**FY 2011-12**
REVENUES:	** See Assumptions and Methodology, plus Technical Considerations**				
EXPENDITURES:					
POSITIONS (cumulative):					

PRINCIPAL DEPARTMENT(S) & PROGRAM(S) AFFECTED: Department of Revenue

EFFECTIVE DATE: January 1, 2007

BILL SUMMARY:
The bill amends GS 105-131.1 and provides that before computing income attributable to the state or distributing income to shareholders, an S Corporation may subtract $25,000 from income.

ASSUMPTIONS AND METHODOLOGY:
The fiscal impact was determined by using 2004 data provided by the Department of Revenue. The 2004 tax year data was adjusted based on projected growth in corporate income for the tax years 2007 to 2012. The corporate income growth estimates are based on Moody's economy.com forecast for U.S. corporate profits. An important assumption needed to make the fiscal estimate was that the income deduction would be between $0 and $25,000. Therefore, additional deductions to other federal adjusted income could not be taken by the taxpayer. For example, an S-Corporation with income of $20,000 could not distribute on a pro rata basis to the S-corporation shareholders the negative balance created by this bill of $5,000 (see Technical Considerations for additional comments). The fiscal impact was estimated by also assuming the effective tax rate

faced by S-corporations is no greater than the corporate tax rate of 6.9%. For FY2007-08, the estimated revenue loss based on these assumptions would be $108.0 million.

The bill creates a deduction to personal income prior to apportionment. Thus, for S-corporations with income prior to apportionment of $25,000 or less, the bill would eliminate all apportioned income to North Carolina. In tax year 2004, the last year of data available, that would have been a reduction in taxable income of $292.1 million.

For S-corporations with income greater than $25,000 prior to apportionment, the bill eliminates $25,000 of income before the S-corporation's apportionment percentage is applied. In tax year 2004, S-corporations in this group would have had their taxable income reduced by $899.9 million. This would have resulted in a revenue loss, in tax year 2004, of approximately $83 million.

SOURCES OF DATA: Department of Revenue

TECHNICAL CONSIDERATIONS: The language in the bill makes no provision for S-corporations with income less than the $25,000 exemption. It also does not create a new section under personal income to allow S-corporation shareholders the mechanism with which to claim a deduction in the event the S-corporation's income is less than $25,000. Therefore, the bill should be amended to either provide a mechanism, through the personal income tax, for S-corporation shareholders to claim a deduction, or limit the exemption in such a way that it does not create a potential deduction for some taxpayers.

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