

GENERAL ASSEMBLY OF NORTH CAROLINA

SESSION 1989

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HOUSE BILL 2066*

Short Title: Tax Fairness Changes.

(Public)

Sponsors: Representatives Lilley, Abernethy, Brawley, Craven, Hasty, Wiser; Balmer, Perdue, Anderson, and Warren.

Referred to: Finance.

May 24, 1990

A BILL TO BE ENTITLED

AN ACT TO AMEND THE TAX FAIRNESS ACT OF 1989 TO PROVIDE TRANSITIONAL ADJUSTMENTS RELATING TO SUBCHAPTER S CORPORATIONS AND DEPRECIATION DEDUCTIONS, TO CORRECT AN ERROR THAT INADVERTENTLY DISALLOWED DEDUCTIONS FOR SOME MORTGAGE INTEREST PAYMENTS, AND TO PROVIDE ADDITIONAL TAX RELIEF FOR TAXPAYERS WITH DEPENDENTS WHO ARE PERMANENTLY AND TOTALLY DISABLED.

The General Assembly of North Carolina enacts:

Section 1. G.S. 105-131.4 reads as rewritten:

"§ 105-131.4. Carryforwards; carrybacks; loss limitation.

(a) Carryforwards and carrybacks to and from an S Corporation shall be restricted in the manner provided in section 1371(b) of the Code.

(b) The aggregate amount of losses or deductions of an S Corporation taken into account by a shareholder pursuant to G.S. 105-131.1(b) may not exceed the combined adjusted bases, determined in accordance with G.S. 105-131.3, of the shareholder in the stock and indebtedness of the S Corporation.

(c) Any loss or deduction that is disallowed for a taxable period pursuant to subsection (b) of this section shall be treated as incurred by the corporation in the succeeding taxable period with respect to that shareholder.

(d) (1) Any loss or deduction that is disallowed pursuant to subsection (b) of this section for the corporation's last taxable period

1 as an S Corporation shall be treated as incurred by the shareholder
2 on the last day of any post-termination transition period.

3 (2) The aggregate amount of losses and deductions taken into account by a
4 shareholder pursuant to subdivision (1) of this subsection may not
5 exceed the adjusted basis of the shareholder in the stock of the
6 corporation (determined in accordance with G.S. 105-131.3 at the
7 close of the last day of any post-termination transition period and
8 without regard to this subsection).

9 (e) Each shareholder's pro rata share of the reduction of an S Corporation's
10 income because of the allowance of a carryforward loss to the S Corporation under this
11 subsection shall be taken into account by the shareholder as a transitional adjustment
12 under G.S. 105-134.7. Notwithstanding the provisions of subsection (a) of this section,
13 an S Corporation that sustained a net economic loss in a taxable year beginning before
14 January 1, 1989, may carry the loss forward to a taxable year beginning on or after
15 January 1, 1989, and before July 1, 1990, and may deduct the loss in that year to the
16 extent it could have carried forward and deducted the loss pursuant to G.S. 105-
17 130.5(b)(4) and G.S. 105-130.8 if the S Corporation Income Tax Act had not become
18 effective until taxable years beginning on or after July 1, 1990. Any loss carryforward
19 allowed as a deduction by this subsection may not exceed the S Corporation's net
20 income, as defined in the Code subject to the adjustments provided in G.S. 105-130.5
21 other than the adjustment provided in G.S. 105-130.5(b)(4), and is subject to the
22 limitations provided in G.S. 105-131.4(b) and (d). Notwithstanding the provisions of
23 G.S. 105-131.3, the basis of a shareholder in the stock of an S Corporation shall be
24 adjusted for the shareholder's pro rata share of the carryforward loss allowed as a
25 deduction to the S Corporation under this subsection. Notwithstanding the provisions of
26 G.S. 105-131.6(c)(2), the accumulated adjustments account maintained for each resident
27 shareholder shall be adjusted for the shareholder's pro rata share of the carryforward
28 loss allowed as a deduction to the S Corporation under this subsection."

29 Sec. 2. G.S. 105-151.19 reads as rewritten:

30 "**§ 105-151.19. Credit for North Carolina dividends.**

31 There is allowed as a credit against the tax imposed by this Division an amount
32 equal to six percent (6%) of the amount of dividends received by the taxpayer during
33 the taxable year from stock issued by a qualified corporation, up to a maximum credit of
34 three hundred dollars (\$300.00) per taxpayer for the taxable year. A corporation is a
35 qualified corporation if fifty percent (50%) or more of the dividends from stock issued
36 by the corporation would be deductible by a corporate shareholder for the taxable year
37 under the provisions of G.S. 105-130.7(1), (2), (3), (3a), or (5) except that no credit
38 shall be allowed for dividends ~~issued with respect to~~ deemed distributable from earnings
39 for a taxable period during which the corporation is an S Corporation subject to the
40 provisions of Division I-S of this Article.

41 This credit applies only with respect to dividends received while the taxpayer was a
42 resident of this State. In the case of a married couple filing a joint return where both
43 spouses received dividends during the taxable year, the three hundred dollar (\$300.00)
44 maximum applies separately to each spouse's dividends for a potential total credit of six

1 hundred dollars (\$600.00) for the couple. This credit may not exceed the amount of tax
2 imposed by this Division for the taxable year reduced by the sum of all credits allowed
3 under this Division, except payments of tax made by or on behalf of the taxpayer."

4 Sec. 3. Notwithstanding any other provision of law, with respect to dividends
5 received by a taxpayer from an S Corporation and included in the taxpayer's North
6 Carolina taxable income under Division II of Article 4 of Chapter 105 of the General
7 Statutes for the taxpayer's 1989 taxable year, if (i) the dividends were distributed during
8 the corporation's 1988 taxable year which began on or after January 2, 1988, and ended
9 on or after January 1, 1989, or (ii) the dividends were distributed before October 1,
10 1989, then the three hundred dollar (\$300.00) limitation in G.S. 105-151.19 shall not
11 apply and any credit otherwise allowable with respect to these dividends shall be
12 allowed without regard to the three hundred dollar (\$300.00) limitation. No additional
13 credit is allowed under G.S. 105-151.19 for dividends distributed on or after October 1,
14 1989, from an S Corporation during its 1989 taxable year, to the extent the taxpayer's
15 total credit under G.S. 105-151.19 for the taxable year exceeds three hundred dollars
16 (\$300.00).

17 Sec. 4. G.S. 105-134.6(b) reads as rewritten:

18 "(b) Deductions. The following deductions from taxable income shall be made in
19 calculating North Carolina taxable income, to the extent each item is included in gross
20 income:

- 21 (1) Interest upon the obligations of (i) the United States or its possessions,
22 (ii) this State or a political subdivision of this State, or (iii) a nonprofit
23 educational institution organized or chartered under the laws of this
24 State.
- 25 (2) Interest upon obligations and gain from the disposition of obligations
26 to the extent the interest or gain is exempt from tax under the laws of
27 this State.
- 28 (3) Benefits received under Title II of the Social Security Act and amounts
29 received from retirement annuities or pensions paid under the
30 provisions of the Railroad Retirement Act of 1937.
- 31 (4) Any amount not to exceed one thousand five hundred dollars (\$1,500)
32 received by the taxpayer during the taxable year as compensation for
33 the performance of duties as a member of the North Carolina
34 organized militia, the national guard as defined in G.S. 127A-3.
- 35 (5) Refunds of State, local, and foreign income taxes included in the
36 taxpayer's gross income.
- 37 (6) a. An amount, not to exceed four thousand dollars (\$4,000), equal to
38 the sum of the amount calculated in subparagraph b. plus the amount
39 calculated in subparagraph c.
40 b. The amount calculated in this subparagraph is the amount
41 received during the taxable year from one or more state, local,
42 or federal government retirement plans.
43 c. The amount calculated in this subparagraph is the amount
44 received during the taxable year from one or more retirement

1 plans other than state, local, or federal government retirement
2 plans, not to exceed a total of two thousand dollars (\$2,000) in
3 any taxable year.

4 d. In the case of a married couple filing a joint return where both
5 spouses received retirement benefits during the taxable year, the
6 maximum dollar amounts provided in this subdivision for
7 various types of retirement benefits apply separately to each
8 spouse's benefits.

9 (7) The amount of inheritance tax attributable to an item of income in
10 respect of a decedent required to be included in gross income under the
11 Code, adjusted as provided in G.S. 105-134.5, 105-134.6, and 105-
12 134.7. The amount of inheritance tax attributable to an item of income
13 in respect of a decedent is (i) the amount by which the inheritance tax
14 paid under Article 1 of this Chapter on property transferred to a
15 beneficiary by a decedent exceeds the amount of inheritance tax that
16 would have been payable by the beneficiary if the item of income in
17 respect of a decedent had not been included in the property transferred
18 to the beneficiary by the decedent, (ii) multiplied by a fraction, the
19 numerator of which is the amount required to be included in gross
20 income for the taxable year under the Code, adjusted as provided in
21 G.S. 105-134.5, 105-134.6, and 105-134.7, and the denominator of
22 which is the total amount of income in respect of a decedent
23 transferred to the beneficiary by the decedent. For an estate or trust,
24 the deduction allowed by this subdivision shall be computed by
25 excluding from the gross income of the estate or trust the portion, if
26 any, of the items of income in respect of a decedent that are properly
27 paid, credited, or to be distributed to the beneficiaries during the
28 taxable year.

29 (8) The amount by which the taxpayer's mortgage interest deduction under
30 the Code was reduced pursuant to section 163(g) of the Code."

31 Sec. 5. G.S. 105-134.7(a) reads as rewritten:

32 "(a) The following adjustments to taxable income shall be made in calculating
33 North Carolina taxable income:

34 (1) Amounts that were included in the basis of property under federal tax
35 law but not under State tax law before January 1, 1989, shall be added
36 to taxable income in the year the taxpayer disposes of the property.

37 (2) Amounts that were included in the basis of property under State tax
38 law but not under federal tax law before January 1, 1989, shall be
39 deducted from taxable income in the year the taxpayer disposes of the
40 property.

41 (3) Amounts that were recognized as income under federal law but not
42 under State law due to a taxpayer's use of the installment method set
43 out in G.S. 105-142(f) prior to January 1, 1989, shall be added to
44 taxable income in the taxpayer's first taxable year beginning on or after

1 January 1, 1989. Amounts that were recognized as income under State
 2 law but not under federal law due to a taxpayer's use of a different
 3 installment method prior to January 1, 1989, shall be deducted from
 4 taxable income in the taxpayer's first taxable year beginning on or after
 5 January 1, 1989.

6 (4) Losses in the nature of net economic losses sustained in any or all of
 7 the five taxable years preceding the taxpayer's first taxable year
 8 beginning on or after January 1, 1989, arising from business
 9 transactions, business capital, or business property, may be deducted
 10 from taxable income subject to the limitations contained in former
 11 G.S. 105-147(9)a., c., and d. (repealed).

12 (5) The amount of any net operating loss for a taxable year beginning on
 13 or after January 1, 1989, carried back to a taxable year beginning
 14 before January 1, 1989, pursuant to section 172 of the Code may be
 15 deducted from taxable income in the taxable year following the taxable
 16 year for which the loss occurred.

17 (6) A loss or deduction that was incurred or paid and deducted from State
 18 taxable income in a taxable year beginning before January 1, 1989, and
 19 is carried forward and deducted in a taxable year beginning on or after
 20 January 1, 1989, under the Code shall be added to taxable income.

21 (7) The transitional adjustments provided in Division I-S of this Article
 22 shall be made with respect to a shareholder's pro rata share of S
 23 Corporation income.

24 (8) Notwithstanding the provisions of subdivision (2) of this subsection, in
 25 the case of property that the taxpayer elected to expense under section
 26 179 of the Code for a taxable year beginning on or before December
 27 31, 1988, the taxpayer shall deduct an allowance for depreciation equal
 28 to the amount that would have been allowed under former G.S. 105-
 29 147(12)(repealed) each year until the amount deductible for
 30 depreciation is equal to the amount deducted under section 179 of the
 31 Code. Amounts deductible under this subdivision may not be
 32 deducted from taxable income under subdivision (2) of this subsection
 33 in the year the taxpayer disposes of the property."

34 Sec. 6. G.S. 105-151.18 reads as rewritten:

35 "**§ 105-151.18. Credit for the disabled.**

36 (a) Disabled Taxpayer. ~~A person-taxpayer~~ who (i) is retired on disability, (ii) at
 37 the time of retirement, was permanently and totally disabled, ~~disabled as defined in section~~
 38 ~~22 of the Code~~, and (iii) claims a federal income tax credit under section 22 of the Code
 39 for the taxable year, is allowed as a credit against the tax imposed by this Division an
 40 amount equal to one-third of the amount of the federal income tax credit for which ~~he~~
 41 the taxpayer is eligible under section 22 of the Code.

42 (b) Disabled Dependent. If a dependent or spouse for whom a taxpayer is
 43 allowed an exemption under the Code is permanently and totally disabled, the taxpayer
 44 is allowed a credit against the tax imposed by this Division. In order to claim the credit

1 allowed by this subsection, the taxpayer must attach to the tax return on which the credit
 2 is claimed a statement from a physician or local health department certifying that the
 3 dependent or spouse for whom the credit is claimed is permanently and totally disabled,
 4 as defined in this section. The amount of the credit allowed shall be determined as
 5 follows: For a taxpayer whose North Carolina adjusted gross income does not exceed
 6 the appropriate income amount provided in the table below, based on the taxpayer's
 7 filing status, the credit allowed is the appropriate initial credit provided in the table
 8 below. For a taxpayer whose North Carolina adjusted gross income does exceed the
 9 appropriate income amount, the credit allowed is the appropriate initial credit reduced
 10 by five dollars (\$5.00) for every one thousand dollars (\$1,000) by which the taxpayer's
 11 North Carolina adjusted gross income exceeds the appropriate income amount.

<u>Filing Status</u>	<u>Initial Credit</u>	<u>Income Amount</u>
<u>Head of Household</u>	<u>\$ 80.00</u>	<u>\$16,000</u>
<u>Surviving Spouse or Joint Return</u>	<u>\$100.00</u>	<u>\$20,000</u>
<u>Married Filing Separately</u>	<u>\$ 50.00</u>	<u>\$10,000</u>

22 (c) Definitions. The following definitions apply in this section:

- 23 (1) North Carolina Adjusted Gross Income. Adjusted gross income, as
 24 determined under the Code, adjusted as provided in G.S. 105-134.6
 25 and G.S. 105-134.7.
- 26 (2) Permanently and Totally Disabled. Unable to engage in any
 27 substantial gainful activity by reason of any medically determinable
 28 physical or mental impairment that can be expected to result in death
 29 or that has lasted or can be expected to last for a continuous period of
 30 not less than 12 months.

31 (d) Limitations. A nonresident or part-year resident who claims the credit
 32 allowed by this section shall reduce the amount of the credit by multiplying it by the
 33 fraction calculated under G.S. 105-134.5(b) or (c), as appropriate. The credit allowed
 34 under this section may not exceed the amount of tax imposed by this Division for the
 35 taxable year reduced by the sum of all credits allowed under this Division, except
 36 payments of tax made by or on behalf of the taxpayer."

37 Sec. 7. Section 1 of this act is effective retroactively for taxable years
 38 beginning on or after January 1, 1989, and shall expire for taxable years beginning on or
 39 after July 1, 1990. Section 6 of this act is effective for taxable years beginning on or
 40 after January 1, 1990. The remainder of this act is effective retroactively for taxable
 41 years beginning on or after January 1, 1989.