

GENERAL ASSEMBLY OF NORTH CAROLINA

SESSION 1989

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SENATE BILL 1364\*

Short Title: Tax Fairness Changes.

(Public)

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Sponsors: Senators Winner, Guy, Kincaid, Rauch, Staton; and Simpson.

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Referred to: Finance.

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May 23, 1990

A BILL TO BE ENTITLED

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

8  
9 The General Assembly of North Carolina enacts:

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

11 "**§ 105-131.4. Carryforwards; carrybacks; loss limitation.**

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

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

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

21 (d) (1) Any loss or deduction that is disallowed pursuant to  
22 subsection (b) of this section for the corporation's last taxable period  
23 as an S Corporation shall be treated as incurred by the shareholder  
24 on the last day of any post-termination transition period.

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

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

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

28 **"§ 105-151.19. Credit for North Carolina dividends.**

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

39           This credit applies only with respect to dividends received while the taxpayer was a  
40 resident of this State. In the case of a married couple filing a joint return where both  
41 spouses received dividends during the taxable year, the three hundred dollar (\$300.00)  
42 maximum applies separately to each spouse's dividends for a potential total credit of six  
43 hundred dollars (\$600.00) for the couple. This credit may not exceed the amount of tax

1 imposed by this Division for the taxable year reduced by the sum of all credits allowed  
2 under this Division, except payments of tax made by or on behalf of the taxpayer."

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

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

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

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

1 plans, not to exceed a total of two thousand dollars (\$2,000) in  
2 any taxable year.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

34 "**§ 105-151.18. Credit for the disabled.**

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

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

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

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

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

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

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