New York State Department of Taxation and Finance
Taxpayer Services Division
Technical Services Bureau

TSB-M-81(11)
Income Tax
Corporation Tax
July 28, 1981

Chapter 103 of the Laws of 1981 renumbered section 660 of the Tax Law to be section 661 and added a new section 660 which provides that where all shareholders of an electing small business corporation (Subchapter S) subject to tax under Article 9-A of the Tax Law consent, all such shareholders will be subject to tax under Article 22 of the Tax Law, and the small business corporation will not be required to pay Article 9-A tax. The law changes apply to taxable years beginning on or after January 1, 1981.

Effect on Shareholders

Where the election has been made, the shareholder must include in his New York adjusted gross income for his taxable year, in which or with which the taxable year of such corporation ends:

1. Dividends received by him from the corporation.

2. His portion of undistributed taxable income of such corporation, without the reduction for taxes imposed by Sections 56 and 1378(a) of the Internal Revenue Code.

3. His portion of any net operating loss of such corporation for a taxable year which ends in or with the taxable year of such shareholder to the extent such loss is deducted by such shareholder pursuant to Section 1374 of the Internal Revenue Code.

In the case of a nonresident shareholder, where the election has been made, such nonresident shareholder's New York adjusted gross income must include the items described in items 1, 2 and 3 above, to the extent such items reflect that portion of the small business corporations income or loss which is derived from carrying on business within New York State using the methods and rules for computing the business allocation percentage provided for under Article 9-A of the Tax Law and the regulations applicable thereto.

Section 612 of the Tax Law has also been amended by Chapter 103 to provide for certain modifications which must be made in cases where the election has been made and also in cases where the election has not been made.

When the election provided for in Section 660 has been made, Section 612(b)(18) provides that the shareholders pro rata share of taxes imposed on the corporation pursuant to Section 56 and 1378(a) must be added to Federal adjusted gross income.

When the election provided for in Section 660 has not been made, modifications are required by Section 612(b)(19), (20), (21) and section 612(c)(21) and (22).

Section 612(b)(19) provides that the shareholder of a Subchapter S corporation must add to his federal adjusted gross income an amount equal to his portion of the net operating loss of the corporation.

Section 612(b)(20) provides that distributions not included in Federal adjusted gross income by virtue of Section 1375(d) of the Internal Revenue Code representing income not previously subject to tax under Article 22 because the election under Section 660 had not been made must be added to Federal adjusted gross income.

Sections 612(b)(21) and 612(c)(21) provide that an amount must be added or subtracted, as the case may be, to federal adjusted gross income as determined pursuant to new Section 612(n).

New Section 612(n) provides that where the election provided for in new Section 660 has not been made in a prior year and a shareholder sells or disposes of some or all of the stock or indebtedness of a Subchapter S corporation, the basis of such stock or indebtedness in such corporation must be adjusted for any year that the election is not made. The adjustments to be made shall determine the New York adjusted basis of the stock or indebtedness. The basis of the stock shall be reduced by the amount it was increased pursuant to Section 1376(a). Conversely, the basis of such stock and indebtedness shall be increased by the amount it was reduced pursuant to 1376(b).

Accordingly, in computing New York adjusted gross income, Federal adjusted gross income or Federal capital loss carryover of the shareholder shall be increased or decreased by an amount equal to the difference between his gain or loss for Federal income tax purposes and his recomputed gain or loss. The modifications to implement these adjustments are contained in Section 612(b)(21) and 612(0)(21).

Section 612(c)(22) provides that the shareholder of a Subchapter S corporation may subtract any amount included in federal adjusted gross income pursuant to Section 1373 of the Internal Revenue Code where the election provided for in new Section 660 has not been made.

Chapter 103 also added a new paragraph (9) to Section 606(a) to provide that, where the election has been made, investment credit be allowed to the shareholders of a small business corporation with respect to qualified property acquired by the small business corporation. The investment credit allowed to the shareholder shall be his pro rata share of such investment credit for his taxable year in which or with which the taxable year of the small business corporation ends. Any available carryover of investment credit based on investment credit allowed to the corporation may not be proportionately distributed to the shareholders. Likewise, any available carryover of investment credit based on investment credit allowed to the shareholders may not be distributed to the corporation. Where investment credit has been claimed by the shareholder pursuant to Section 606(a)(9), and such shareholder's proportionate stock interest in the small business corporation is reduced, such shareholder must restore a portion of the investment credit claimed.

The election provided for in Section 660 must be made by the shareholders by filing a completed form CT-6, Election by Shareholders of a Small Business Corporation for New York State Personal Income Tax and Corporation Franchise Tax Purposes. The form provides a statement of consent and it must be signed by <u>all the shareholders</u> to be effective. Each person who is a shareholder of a qualified small business corporation must consent to the election. If husband and wife are co-owners, both must consent to the election.

The election for the initial year, that is any taxable year of a corporation beginning on or after January 1, 1981 and ending prior to December 31, 1982 may be made within nine months from the beginning date of such taxable year.

Thereafter, the election must be made during the preceding taxable year of the Subchapter S corporation or at any time during the first 75 days of such corporation's taxable year. If the election is made after the first 75 days of the corporation's taxable year and on or before the last day of such corporation's taxable year, the election shall be treated as made for the following year.

The election is effective for the taxable year for which it is made and for all succeeding taxable years of the corporation unless:

1. The election is no longer applicable by virtue of the termination of the election pursuant to Section 1372(e) of the Internal Revenue Code, or

2. one or more shareholders revokes his election in the manner prescribed by the Tax Commission by regulation, or

3. a new shareholder affirmatively refuses to consent to the election.

Where a revocation is made during the first month of a corporation's taxable year, it will be effective for that taxable year and for subsequent years. If the revocation is made at any other time during the taxable year, it will become effective for the next taxable year and for subsequent years. A revocation cannot be made effective for the first taxable year for which the election is effective. A revocation must be made in such manner as the Tax Commission shall prescribe by regulations.

Section T46-112.0 of the Administrative of the City of New York has been correspondingly amended to conform with the amendments made to Article 22 of the Tax Law.

Effect on the small business corporation

The corporation will be required to file the election, form CT-6, with the Department of Taxation and Finance. The election should be sent to the following address:

Processing Division
Registration Process Section Corporation Tax
Bldg. #8, Room #409
State Campus
Albany, New York 12227

The small business corporation will still be required to file the corporation franchise tax return, form CT-3 or CT-4 along with a copy of corresponding Federal Form 1120S.

Where the election by all the shareholders of a small business corporation is made, the small business corporation will not be required to pay Article 9-A tax. However, foreign corporations will continue to be subject to the following FEES imposed by Section 181 of Article 9 even though the election is made:

> Section 181.1 imposes a LICENSE FEE upon every foreign corporation doing business in New York State. The fee is payable only once unless the allocated capital structure of the corporation changes and the resulting license fee is higher than the fee previously paid. The license fee is computed and paid on form CT-240.
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> Section 181.2 imposes an ANNUAL MAINTENANCE FEE of $200.00 upon foreign corporations that are authorized to do business in New York State. The maintenance fee will be paid on the corporation franchise tax return, form CT-3 or CT-4.

It should be noted that if the election is made the corporation may not claim any net operating loss as a carryforward or a carryback. Therefore, the computation of the entire net income on the New York State Corporation Franchise Tax Report, Form CT-3, will not include a net operating loss deduction in the years in which the election is taken and subsequent years.

If the election is made and the corporation has made a mandatory payment, declaration and payment of estimated tax, or any payment that applies to the initial year of the election, then a refund is due. The refund should be claimed on the corporation franchise tax report filed for the initial year of the election. In addition, a copy of form CT-6 must be attached to the CT-3 or CT-4 Report.