
*American Bar Association Section of Taxation
Committee on S Corporations
Subcommittee on the State Taxation of S Corporations
June 1989 (Revised)*

Model S Corporation Income Tax Act

*Recommended (with Six Proposed Modifications) to the States
by the Multistate Tax Commission, August 2, 1991*

I. BASIC PROVISIONS

**SECTION 1000. TITLE; DEFINITIONS; FEDERAL CONFORMITY;
CONSTRUCTION**

- (a) The title of this Part shall be the [name of State] S Corporation Income Tax Act.
- (b) For purposes of this Part, the following terms shall have the following meanings:
- (1) C Corporation: a corporation which is not an S Corporation.
- (2) Code: the Internal Revenue Code of 1986, as amended and as applicable to the Taxable Period; references to sections of the Code shall be deemed to refer to corresponding provisions of prior and subsequent federal tax laws.
- (3) Income Attributable to the State: items of income, loss, deduction or credit of the S Corporation apportioned to this State pursuant to [Section number—business income apportionment provision] or allocated to this State pursuant to [Section number—nonbusiness income allocation provision].
- (4) Income Not Attributable to the State: all items of income, loss, deduction or credit of the S Corporation other than Income Attributable to the State.
- (5) Post-Termination Transition Period: that period defined in Section 1377(b)(1) of the Code.
- (6) Pro Rata Share: the portion of any item attributable to an S Corporation shareholder for a Taxable Period determined in the manner provided in, and subject to any election made under, Section 1377(a) or 1362(e), as the case may be, of the Code.
- (7) S Corporation: a corporation for which a valid election under Section 1362(a) of the Code is in effect.

Multistate Tax Commission

(8) Taxable Period: any taxable year or portion of a taxable year during which a corporation is an S Corporation.

(c) Except as otherwise expressly provided or clearly appearing from the context, any term used in this Part shall have the same meaning as when used in a comparable context in the Code, or in any statute relating to federal income taxes, in effect for the Taxable Period. Due consideration shall be given in the interpretation of this Part to applicable sections of the Code in effect from time to time and to federal rulings and regulations interpreting such sections, provided such Code, rulings and regulations do not conflict with the provisions of this Part.

(d) This Act shall be applied and construed to effectuate its general purpose to make uniform the law with respect to the subject matter of this Act among States enacting it.

SECTION 1001. TAXATION OF AN S CORPORATION AND ITS SHAREHOLDERS

(a) [Alternative No. 1] An S Corporation shall not be subject to the tax imposed by [Section number—taxation of C Corporations].

(a) [Alternative No. 2] Except as provided in the following sentence, an S Corporation shall not be subject to the tax imposed by [Section number—taxation of C Corporations]. If an S Corporation is subject to federal income tax on any of its income, then the amount of such income, as modified pursuant to Section 1002 of this Part, that constitutes Income Attributable to the State shall be subject to the tax imposed by [Section number—taxation of C Corporations]. The S Corporations Income Attributable to the State shall be reduced by the amount of any tax imposed on the corporation pursuant to the preceding sentence.

(b) For purposes of [Section number—taxation of individuals], each shareholder's Pro Rata Share of the S Corporation's Income Attributable to the State and each resident shareholder's Pro Rata Share of the S Corporation's Income Not Attributable to the State, as modified pursuant to Section 1002 of this Part, shall be taken into account by the shareholder in the manner provided in Section 1366 of the Code.

(c) For purposes of determining the amounts taken into account by the shareholders of an S Corporation pursuant to subsection (b), the amount of any tax imposed on the S Corporation under the Code shall proportionately reduce the S Corporation's Income Attributable to the State and Income Not Attributable to the State.

SECTION 1002. MODIFICATION AND CHARACTERIZATION OF INCOME

(a) An S Corporation's Income Attributable to the State shall, for purposes of Section 1001 of this Part, be subject to the modifications provided in [Section number—corporate modifications].

(b) The Pro Rata Share of each resident shareholder of an S Corporation in the Income Not Attributable to the State shall, for purposes of Section 1001(b) of this Part, be subject to the modifications provided in [Section number—individual modifications].

(c) The character of any S Corporation item taken into account by a shareholder of an S Corporation pursuant to Section 1001(b) of this Part shall be determined as if such item were received or incurred by the S Corporation and not its shareholder.

SECTION 1003. BASIS AND ADJUSTMENTS

(a) The initial basis in the hands of a resident shareholder of an S Corporation in the stock of the S Corporation and any indebtedness of the S Corporation to the shareholder shall be determined in the manner provided under the Code, and shall be determined as of the date (which may be before the effective date of this Part) that is the latest to occur of (1) the date on which the shareholder last became a resident of this State, (2) the date on which the shareholder acquired the stock or the indebtedness of the corporation, or (3) the effective date of the corporation's most recent S election under the Code.

(b) The initial basis of a resident shareholder in the stock and indebtedness of an S Corporation shall be adjusted after the date specified in subsection (a) in the manner and to the extent required by Section 1011 of the Code except that, with respect to any Taxable Period during which the shareholder is a resident of this State—

(1) any modifications made (other than for income exempt from federal or this State's taxation) pursuant to Section 1002 of this Part [(and any provision of prior State law similar to this subsection (b), without regard to subsection (b)(2))] shall be taken into account; and

(2) any adjustments made pursuant to Section 1367 of the Code for a Taxable Period during which this State did not measure the income of a shareholder of an S Corporation by reference to the S Corporation's income shall not be taken into account.

(c) The initial basis in the hands of a nonresident shareholder of an S Corporation in the stock of the S Corporation and any indebtedness of the S Corporation to the shareholder shall be zero as of the date (which may be before the effective date of this Part) that is the latest to occur of (1) the date on which the shareholder last became a nonresident of this State, (2) the date on which the shareholder acquired the stock or the indebtedness of the corporation, or (3) the effective date of the corporation's most recent S election under the Code.

(d) The initial basis of a nonresident shareholder in the stock and indebtedness of an S Corporation shall be adjusted after the date specified in subsection (c) as provided in Section 1367 of the Code, except that such adjustments shall be limited to that portion of the Income Attributable to the State that is taken into account by the shareholder pursuant to Section 1001(b) of this Part [(and any provision of prior State law similar to this subsection (d))]. In computing

Multistate Tax Commission

Income Attributable to the State for purposes of the preceding sentence, any modification made for income exempt from federal or this State's taxation shall not be taken into account.

(e) The basis in the hands of a resident shareholder of an S Corporation in the stock of the S Corporation shall be reduced by the amount allowed as a loss or deduction pursuant to Section 1004(d) of this Part.

(f) The basis in the hands of a resident shareholder of an S Corporation in the stock of the S Corporation shall be reduced by the amount of any cash distribution which is not taxable to the shareholder as a result of the application of Section 1006(b) of this Part.

(g) For purposes of this section, any person acquiring stock or indebtedness of an S Corporation by gift from a person who is a resident of this State at the time of the gift shall be considered to have acquired the stock or indebtedness at the time the donor acquired the stock or indebtedness.

SECTION 1004. CARRYOVERS AND CARRYBACKS; LOSS LIMITATION

(a) Carryforwards and carrybacks to and from Taxable Periods of 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 of the S Corporation for a Taxable Period pursuant to Section 1001(b) of this Part shall not exceed the shareholder's combined adjusted basis, determined in accordance with Section 1003 of this Part, in the stock of the S Corporation and any indebtedness of the S Corporation to the shareholder.

(c) Any loss or deduction of an S Corporation which is disallowed for a Taxable Period pursuant to subsection (b) shall be treated as incurred by the corporation in the succeeding Taxable Period with respect to that shareholder.

(d) (1) Any loss or deduction of an S Corporation which is disallowed pursuant to subsection (b) for the corporation's last Taxable Period as an S Corporation shall be treated as incurred by a shareholder on the last day of any Post-Termination Transition Period.

(2) The aggregate amount of losses and deductions taken into account by a shareholder pursuant to subsection (d)(1) shall not exceed the shareholder's adjusted basis in the stock of the corporation (determined in accordance with Section 1003 of this Part at the close of the last day of any Post-Termination Transition Period and without regard to this subsection (d)).

(e)[Optional subsection] Any loss or deduction of an S Corporation for a Taxable Period that is not taken into account by a shareholder of the S Corporation pursuant to [Section numbers—at-risk, passive loss, etc. limitations] shall be treated as incurred by the corporation in the succeeding Taxable Period with respect to that shareholder.

SECTION 1005. PART-YEAR RESIDENCE

For purposes of this Part, if a shareholder of an S Corporation is both a resident and nonresident of this State during any Taxable Period, the shareholder's Pro Rata Share of the S Corporation's Income Attributable to the State and Income Not Attributable to the State for the Taxable Period shall be further prorated between the shareholder's periods of residence and nonresidence during the Taxable Period, in accordance with the number of days in each period.

SECTION 1006. DISTRIBUTIONS

(a) Subject to subsection (c), a distribution made by an S Corporation with respect to its stock to a resident shareholder shall be taken into account by the shareholder for purposes of [Section number—taxation of individuals] to the extent that the distribution is treated as a dividend or as gain from the sale or exchange of property pursuant to Section 1368 of the Code.

(b) Subject to subsection (c), a distribution of money made by a corporation with respect to its stock to a resident shareholder during a Post-Termination Transition Period shall not be taken into account by the shareholder for purposes of [Section number—taxation of individuals] to the extent the distribution is applied against and reduces the adjusted basis of the stock of the shareholder in accordance with Section 1371(e) of the Code.

(c) In applying Sections 1368 and 1371(e) of the Code to any distribution referred to in subsection (a) or (b)—

(1) the term "adjusted basis of the stock" shall mean the shareholder's adjusted basis in the stock of the S Corporation, as determined under Section 1003 of this Part; and

(2) the term "accumulated adjustments account" shall mean an amount that is equal to, and adjusted in the same manner as, the S Corporation's accumulated adjustments account defined in Section 1368(e)(1)(A) of the Code, except that any modifications required to be made pursuant to Section 1002(a) of this Part shall be taken into account.

SECTION 1007. RETURNS; SHAREHOLDER AGREEMENTS; MANDATORY PAYMENTS

(a) An S Corporation which engages in activities in this State which would subject a C Corporation to the requirement to file a return under [Section number—taxation of C Corporations] shall file with the [State taxing authority] an annual return, in the form prescribed by the [State taxing authority], on or before the due date prescribed for the filing of C Corporation returns under [Section number—corporate tax return filing date]. The return shall set forth the name, address and social security or federal identification number of each

Multistate Tax Commission

shareholder; the Income Attributable to the State and Income Not Attributable to the State with respect to each shareholder as determined under this Part; the modifications required by Section 1002 of this Part; and such other information as the [State taxing authority] may by regulation prescribe. The S Corporation shall, on or before the day on which such return is filed, furnish to each person who was a shareholder during the year a copy of such information shown on the return as the [State taxing authority] may by regulation prescribe. The S Corporation shall also maintain the accumulated adjustments account described in Section 1006(c)(2) of this Part.

(b) The [State taxing authority] shall permit S Corporations to file composite returns and to make composite payments of tax on behalf of some or all of its nonresident shareholders. The [State taxing authority] may permit composite returns and payments to be made on behalf of resident shareholders.

(c) With respect to each of its nonresident shareholders, an S Corporation shall for each Taxable Period either (1) timely file with the [State taxing authority] an agreement as provided in subsection (d) or (2) make a payment to this State as provided in subsection (e). An S Corporation that timely files an agreement as provided in subsection(d) with respect to a nonresident shareholder for a Taxable Period shall be considered to have timely filed such an agreement for each subsequent Taxable Period. An S Corporation that does not timely file such an agreement for a Taxable Period shall not be precluded from timely filing such an agreement for subsequent Taxable Periods.

(d) The agreement referred to in subsection (c)(1) is an agreement of a non-resident shareholder of the S Corporation—

(1) to file a return in accordance with the provisions of [Section number—individual tax return filing requirement] and to make timely payment of all taxes imposed on the shareholder by this State with respect to the income of the S Corporation; and

(2) to be subject to personal jurisdiction in this State for purposes of the collection of income taxes, together with related interest and penalties, imposed on the shareholder by this State with respect to the income of the S Corporation.

The agreement will be considered to be timely filed for a Taxable Period (and for all subsequent Taxable Periods) if it is filed at or before the time the annual return for such Taxable Period is required to be filed pursuant to subsection (a).

(e)The payment referred to in subsection (c)(2) shall be in an amount equal to the highest marginal tax rate in effect under [Section number—individual tax rates] multiplied by the shareholder's Pro Rata Share of the Income Attributable to the State reflected on the corporation's return for the Taxable Period. An S Corporation shall be entitled to recover a payment made pursuant to the preceding sentence from the shareholder on whose behalf the

payment was made. Any such payment for a Taxable Period must be made at or before the time the annual return for such Taxable Period is required to be filed pursuant to subsection (a).

(f) Any amount paid by the corporation to this State pursuant to subsection (b) or (e) shall be considered to be a payment by the shareholder on account of the income tax imposed on the shareholder for the Taxable Period pursuant to [Section number—taxation of individuals].

SECTION 1008. TAX CREDITS

(a) For purposes of [Section number—individual tax credit allowance provisions], each resident shareholder shall be considered to have paid a tax imposed on the shareholder in an amount equal to the shareholder's Pro Rata Share of any net income tax paid by the S Corporation to a State which does not measure the income of shareholders of an S Corporation by reference to the income of the S Corporation. For purposes of the preceding sentence, the term "net income tax" means any tax imposed on or measured by a corporation's net income.

(b) [Optional] Each shareholder of an S Corporation shall be allowed a credit against the tax imposed by [Section number—taxation of individuals] in an amount equal to the shareholder's Pro Rata Share of the tax credits described in [Section number—policy tax credits available to a C Corporation].

II. ADDENDUM: CONFORMING PROVISIONS

A. LIFO RECAPTURE (OPTIONAL)

If a corporation is subject to LIFO recapture pursuant to Section 1363(d) of the Code, then—

(1) any increase in the tax imposed by [Section number—taxation of C Corporations] by reason of the inclusion of the LIFO recapture amount in its income shall be payable in four equal installments;

(2) the first installment shall be paid on or before the due date (determined without regard to extensions) for filing the return for the first taxable year for which the corporation was subject to the LIFO recapture;

(3) the three succeeding installments shall be paid on or before the due date (determined without regard to extensions) for filing the corporation's return for the three succeeding taxable years; and

(4) for purposes of computing interest on underpayments, the last three installments shall not be considered underpayments until after the payment due date specified above.

B. SAMPLE INDIVIDUAL INCOME TAX PROVISION

[To be inserted in the section determining State taxable income of individuals]

Notwithstanding any other provision of this statute [or other statute designation], a shareholder of an S Corporation (as defined in Section 1000(b)(7)) shall take into account the income, loss, deduction or credit of the S Corporation only to the extent provided in Section 1001(b).

C. SAMPLE CORPORATE INCOME TAX PROVISIONS

[Alternative A—to be inserted in the section determining State taxable income of corporations when an S Corporation is never subject to income tax]

Notwithstanding any other provision of this statute [or other statute designation], an S Corporation (as defined in Section 1000(b)(7)) shall not be subject to the income tax imposed under this section.

[Alternative B—to be inserted in the section determining State taxable income of corporations when an S Corporation will be subject to income tax]

Notwithstanding any other provision of this statute [or other statute designation], an S Corporation (as defined in Section 1000(b)(7)) shall be taxed on its income only to the extent provided in Section 1001(a).

**Six Proposed Modifications to
The American Bar Association
Model S Corporation Income Tax Act**

[Note that the Six Proposed Modifications contained in this document have been developed to suggest amendatory language to states considering the American Bar Association Model S Corporation Income Tax Act that would be consistent with existing state tax policy. In this sense, an adopting state is not encouraged to adopt any of the Six Proposed Modifications unless the modification being considered is consistent with existing state tax policy of the state and the adopting state wishes to preserve the existing policy choice represented by one or more of the Six Proposed Modifications.]

PROPOSED MODIFICATION #1

(Accommodating state restrictions against incorporation
of the Internal Revenue Code *in futuro*)

Original Draft: Section 1000(b)(2)--

Code: the Internal Revenue Code of 1986, as amended and as applicable to the Taxable Period; reference to sections of the Code shall be deemed to refer to corresponding provisions of prior and subsequent federal tax laws.

Original Draft: Section 1000(c)--

Except as otherwise expressly provided or clearly appearing from the context, any term used in this Part shall have the same meaning as when used in a comparable context in the Code, or in any statute relating to federal income taxes, in effect for the Taxable Period. Due consideration shall be given in the interpretation of this Part to applicable sections of the Code in effect from time to time and to federal rulings and regulations interpreting such sections, provided such Code, rulings and regulations do not conflict with the provisions of this Part.

Optional Draft: Section 1000(b)(2) [MTC Alternative]--

Code: the Internal Revenue Code of 1986, as amended and as applicable to the Taxable Period pursuant to [Section number--state provision conforming state tax laws to the Internal Revenue Code as of a specified date including to the extent noted provisions amended, deleted, or added thereto prior to the applicable effective date].

Optional Draft: Section 1000(c) [MTC Alternative]--

Except as otherwise expressly provided in this Part or other applicable law or clearly appearing from the context, any term used in this Part shall have the same meaning as when used in a comparable context in the Code, or in any statute relating to federal income taxes, in effect for the Taxable Period pursuant to [Section number--state provision conforming state tax laws to the Internal Revenue Code as of a specified date including to the extent noted provisions amended, deleted, or added thereto prior to the applicable effective date]. Due consideration shall be given in the interpretation of this Part to analogous sections of the Code and to federal rulings and regulations interpreting such sections, provided such Code, rulings and regulations do not conflict with the provisions of this Part.

PROPOSED MODIFICATION #2

(Permitting entity level taxation by states in addition to the taxation of federal built-in gains and excessive passive net income)

Original Draft: Section 1001(a) [Alternative No. 2]--

Except as provided in the following sentence, an S Corporation shall not be subject to the tax imposed by [Section number--taxation of C corporations]. If an S Corporation is subject to federal income tax on any of its income, then the amount of such income, as modified pursuant to Section 1002 of this Part, that constitutes Income Attributable to the State shall be subject to the tax imposed by [Section number--taxation of C corporations]. The S Corporations Income Attributable to the State shall be reduced by the amount of any tax imposed on the corporation pursuant to the preceding sentence.

Optional Draft A: Section 1001(a) [MTC Alternative A] --

An S Corporation's Income Attributable to the State shall be subject to the tax imposed by [Section number--special tax on the income of S Corporations] and, for purposes of determining the amounts taken into account by the shareholder of an S Corporation pursuant to subsection (b), the amount of the tax shall reduce the S Corporation's Income Attributable to the State. An S corporation shall not be subject to the tax imposed by [Section number--taxation of C Corporations].

Optional Draft B: Section 1001(a) [MTC Alternative B]--

An S Corporation shall not be subject to the tax imposed by [Section number--taxation of C Corporations], except:

(1) If an S Corporation is subject to federal income tax on any of its income, then the amount of such income, as modified pursuant to Section 1002 of this Part, that constitutes Income Attributable to the State shall be subject to the tax imposed by [Section number--taxation of C Corporations].

(2) An S Corporation's Income Attributable to the State, less the amount of income subject to the tax imposed under paragraph (1) of this subsection, shall be subject to the tax imposed by [Section number--special tax on income of S Corporations].

For purposes of determining the amounts taken into account by the shareholders of an S Corporation pursuant to subsection (b), the amount of any tax imposed pursuant to this subsection shall reduce the S Corporation's Income Attributable to the State.

PROPOSED MODIFICATION #3

(Providing for an alternative which denies resident shareholder credit for entity-level tax imposed by non-recognition state)

Original Draft: Section 1008(a)--

For purposes of [Section number--individual tax credit allowance provisions], each resident shareholder shall be considered to have paid a tax imposed on the shareholder in an amount equal to the shareholder's Pro Rata Share of any net income tax paid by the S Corporation to a state which does not measure the income of shareholders of an S Corporation by reference to the income of the S Corporation. For purposes of the preceding sentence, the term "net income tax" means any tax imposed on or measured by a corporation's net income.

Optional Draft: Section 1008(a) [MTC Alternative]--

For purposes of [Section number--individual tax credit allowance provisions], a net income tax imposed on an S Corporation by another state shall not be creditable against the shareholder's tax liability.

PROPOSED MODIFICATION #4

(Providing for an alternative that prevents an automatic deduction of another state's income taxes by reason of the operation of IRC § 164)

Original Draft: Section 1002(b)--

The Pro Rata Share of each resident shareholder of an S Corporation in the Income Not Attributable to the State shall, for purposes of Section 1001(b) of this Part, be subject to the modifications provided in [Section number--individual modifications].

Optional Draft: Section 1002(b) [MTC Alternative]--

The Pro Rata Share of each resident shareholder of an S Corporation in the Income Not Attributable to the State shall, for purposes of Section 1001(b) of this Part, be--

(1) subject to the modifications provided in [Section number--individual modifications]; and

(2) increased by the amount of the shareholder's Pro Rata Share of any income tax imposed on the corporation by another state.

PROPOSED MODIFICATION #5

(Alternative provision which prohibits reduction of state taxable income passed through to the shareholders for federal Code Section 1374 and 1375 taxes imposed on the corporation.)

Original Draft: Section 1001(c)--

For purposes of determining the amounts taken into account by the shareholders of an S Corporation pursuant to subsection (b), the amount of any tax imposed on the S Corporation under the Code shall proportionately reduce the S Corporation's Income Attributable to the State and Income Not Attributable to a State.

Optional Draft: Section 1001(c) [MTC Alternative]--

For purposes of determining the amounts taken into account by the shareholders of an S Corporation pursuant to subsection (b), the amount of any tax imposed on the S Corporation under the Code shall not reduce the S Corporation's Income Attributable to the State and Income Not Attributable to a State.

PROPOSED MODIFICATION #6

(Optional provision requiring informational return to be filed by S Corporation in states where it has resident shareholders even though S Corporation does not operate within such state)

Original Draft: Section 1007(a)--

An S Corporation which engages in activities in this State which would subject a C Corporation to the requirement to file a return under [Section number--taxation of C Corporation] shall file with the [State taxing authority] an annual return, in the form prescribed by the [State taxing authority], on or before the due date prescribed for the filing of C Corporation returns under [Section number--corporate tax return filing date]. The return shall set forth the name, address and social security or federal identification number of each shareholder; the Income Attributable to the State and Income Not Attributable to the State with respect to each shareholder as determined under this Part; the modifications required by Section 1002 of this Part; and such other information as the [State taxing authority] may by regulations prescribe. The S Corporation shall, on or before the day on which such return is filed, furnish to each person who was a shareholder during the year a copy of such information shown on the return as the [State taxing authority] may by regulation prescribe. The S Corporation shall also maintain the accumulated adjustments account described in Section 1006(c)(2) of this Part.

Optional Draft: Section 1007(a) [MTC Alternative]--

Every S Corporation which engages in activities in this State which would subject a C Corporation to the requirement to file a return under [Section number--taxation of C Corporation] or which has a shareholder resident in this state shall file with the [State taxing authority] an annual return, in the form prescribed by the [State taxing authority], on or before the due date prescribed for the filing of C Corporation returns under [Section number--corporate tax return filing date]. The return shall set forth the name, address, social security or federal identification number, and last known address or residence of each shareholder; the Income Attributable to the State and Income Not Attributable to the State with respect to each shareholder as determined under this Part; the modifications required by Section 1002 of this Part; and such other information as the [State taxing authority] may by regulations prescribe. The S Corporation shall, on or before the day on which such return is filed, furnish to each person who was a shareholder during the year a copy of such information shown on the return as the [State taxing authority] may by regulation prescribe. The S Corporation shall also maintain the accumulated adjustments account described in Section 1006(c)(2) of this Part.