

DEPARTMENT OF TAXATION

2007 Fiscal Impact Statement

1. **Patron** Walter A. Stosch

2. **Bill Number** SB 1283

House of Origin:

 Introduced

 Substitute

 Engrossed

3. **Committee** Passed House and Senate

4. **Title** Individual Income Tax; Shareholders of S
Corporations Subject to the Bank Franchise
Tax

Second House:

 In Committee

 Substitute

 X **Enrolled**

5. **Summary/Purpose:**

This bill would allow a shareholder of an electing small business corporation (S corporation) that was subject to the bank franchise tax for the calendar year in which the taxable year began to subtract the shareholder's allocable share of the income or gain of the S corporation, to the extent that it was included in his federal adjusted gross income. In addition, such a taxpayer would be required to add back his allocable share of the losses or deductions of the S corporation, to the extent that it was included in his federal adjusted gross income.

These taxpayers would also be required to add back any distribution paid or distributed to the shareholders by the S corporation to the extent that such distributions were excluded from federal adjusted gross income.

This bill would be effective for taxable years beginning on or after January 1, 2007.

6. **Fiscal Impact Estimates are:** Not available. (See Line 8.)

7. **Budget amendment necessary:** No.

8. **Fiscal implications:**

Administrative Costs

TAX considers implementation of this bill as routine, and does not require additional funding.

Revenue Impact

The revenue impact of this bill is unknown because TAX does not possess the data that would be required in order to identify the number of banks that are organized as electing small business corporations (S corporations). While the revenue impact would depend on the profitability and number of the affected entities, TAX believes that it would apply to only a few small banks.

9. Specific agency or political subdivisions affected:

Department of Taxation

10. Technical amendment necessary: No.

11. Other comments:

Background

The Virginia bank franchise tax is imposed at a rate of 1% of the net capital of banks and trust companies. Cities, counties and towns are permitted to impose a local bank franchise tax not to exceed 80% of the state rate. Banks and trust companies are granted a credit against the state tax equal to the local tax imposed.

Banks and trust companies pay the bank franchise tax in lieu of the Virginia corporate income tax and local business, professional, and occupational license tax, and the merchants' capital tax. In addition, banks and trust companies can exclude certain personal property from tangible personal property taxation.

Banks are subject to this tax no matter how they are organized. Thus, unlike most other pass-through entities, banks organized as electing small business corporations (S corporations) are taxed at the entity level. Because of this, shareholders of these banks must pay the entity-level bank franchise tax and then must also pay individual income tax on the income or gain that has been passed through to the taxpayer.

Before 1997 banks could not elect S corporation status. In 1996 the federal law was amended to allow banks that did not use bad debt reserves to elect S corporation status.

Proposal

This bill would allow a shareholder of an electing small business corporation (S corporation) that was subject to the bank franchise tax for the calendar year in which the taxable year began to subtract the shareholder's allocable share of the income or gain of the S corporation, to the extent that it was included in his federal adjusted gross income. In addition, such a taxpayer would be required to add back his allocable share of the losses or deductions of the S corporation, to the extent that it was included in his federal adjusted gross income.

These taxpayers would also be required to add back the value of any distribution paid or distributed to the shareholders by the S corporation to the extent that such distributions were excluded from federal adjusted gross income.

cc : Secretary of Finance

Date: 2/23/2007 AMS
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