



Guideline

Income Tax

Adjustment for Income (Loss) From An S Corporation Electing to be Taxed as a C Corporation

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December 2014

Introduction

This guideline explains the adjustment to income that must be made on the North Dakota income tax return of a shareholder of a subchapter S corporation that elects to be taxed as a C corporation under North Dakota Century Code § 57-38-01.35. An S corporation that makes the election to be taxed as a C corporation under this provision will pay North Dakota income tax on its income at the corporation entity level. However, because the corporation is still treated as an S corporation for federal income tax purposes, its income will be passed through to its shareholders who must include it in their federal taxable income. This will result in the corporation's income becoming subject to North Dakota income tax a second time at the shareholder level because federal taxable income is the starting point in calculating the shareholder's North Dakota taxable income. To prevent the income from being taxed twice for state income tax purposes (or, in the case of a loss, to prevent a double deduction), an adjustment to income must be made on the shareholder's North Dakota income tax return to remove the income (or loss) from the shareholder's North Dakota taxable income.

This guideline has the following two purposes:

1. For the corporation, it explains how to calculate the adjustment to income and report it to its shareholders.
2. For the shareholder, it explains how to report the adjustment to income on the shareholder's North Dakota income tax return.

Information for corporation

The amount of the adjustment to income is equal to each shareholder's distributive share of the corporation's North Dakota income (or loss), as modified to remove North Dakota statutory adjustments and any renaissance zone income exemption amount. If there are any modifications, or if the corporation does not apportion and allocate all of its income or loss to North Dakota, the adjustment to income on the shareholder's North Dakota income tax return will differ from the income or loss reported on the shareholder's federal income tax return. The adjustment to income will decrease or increase the shareholder's North Dakota taxable income depending on whether the corporation has a net income or loss, respectively, for North Dakota corporation income tax purposes.

The adjustment to income is calculated as follows:

1. In completing Form 40, if the corporation used:
 - **Single Corporate Entity Method**, enter the amount from Form 40, page 1, line 1.
 - **Combined Report Method**, enter the amount from Form 40, page 4, Schedule WW, line 3, or from page 5, Schedule WE, line 1, whichever applies.

}1 _____

2. Apportionment factor from Form 40, page 1, line 52 _____
3. Multiply line 1 by line 2.....3 _____
4. Amount from Form 40, page 1, line 7.....4 _____
5. Add lines 3 and 45 _____
6. Renaissance zone income exemption from Form 40, page 1, line 10.
Enter as a positive number6 _____
7. Adjustment to income. If line 6 is equal to or greater than line 5,
enter zero; otherwise, subtract line 6 from line 5.....7 _____

Statement for shareholder

On or before the due date (or extended due date) for filing Form 40, the corporation must give a statement to each shareholder containing the following:

1. The statement: **This statement contains information that is important to the preparation of your North Dakota income tax return. For instructions on how to report the “N.D.C.C. § 57-38-01.35 adjustment to income” amount shown on this statement on your North Dakota income tax return, obtain the *Income Tax Guideline: Adjustment For Income (Loss) From An S Corporation Electing to be Taxed as a C Corporation* from the North Dakota Office of State Tax Commissioner’s web site at www.nd.gov/tax.**
2. Name, address, and federal employer identification number of the corporation.
3. Tax year of the corporation for which the statement is provided.
4. The shareholder’s share of the adjustment to income amount calculated by the corporation, identified on the statement as “N.D.C.C. § 57-38-01.35 adjustment to income.”

Alternative to statement for shareholder. As an alternative to providing the separate statement for shareholder described above, the corporation may report the same information in the supplemental information section of the federal Schedule K-1 (Form 1120-S) provided to each shareholder. The information must be clearly identified as North Dakota tax information, with an instruction that it is important to the preparation of the shareholder’s North Dakota income tax return.

Information for shareholder

The shareholder must report the “N.D.C.C. § 57-38-01.35 adjustment to income” on the shareholder’s North Dakota income tax return as follows:

- Report the adjustment amount on the North Dakota return filed for the same tax year in which the distributive share of the corporation’s income or loss is reported on the shareholder’s federal income tax return.
- **Income adjustment.** If the adjustment amount is positive—that is, it consists of the passthrough of the corporation’s net income—it must be subtracted from federal taxable income in determining the shareholder’s North Dakota taxable income, but only to the extent it increased federal taxable income. Enter the amount as a subtract adjustment on the appropriate line of Form ND-1 (if an individual) or Form 38 (if an estate or trust).

- **Loss adjustment.** If the adjustment amount is negative—that is, it consists of the passthrough of the corporation’s net loss—it must be added to federal taxable income in determining the shareholder’s North Dakota taxable income, but only to the extent it reduced federal taxable income. Enter the amount as an addition adjustment on the appropriate line of Form ND-1 (if an individual) or Form 38 (if an estate or trust).

If the shareholder is a nonresident of North Dakota whose only income or loss from North Dakota sources is the distributive share of income or loss from the corporation, the shareholder does not have to file a North Dakota income tax return. If this applies, disregard the instructions provided in this section of the guideline.

Need assistance or forms?

Phone: 701.328.1247

Speech/hearing impaired—call us through Relay North Dakota at 1.800.366.6888

E-mail: individualtax@nd.gov

Web site: www.nd.gov/tax