

17 NCAC 06B .4006 DISTRIBUTIONS

(a) A resident shareholder must take into account distributions from an S corporation in computing North Carolina taxable income to the extent the distributions are characterized as dividends or as gains pursuant to Section 1368 of the Internal Revenue Code. Section 1368 of the Code provides that if the S corporation has no accumulated earnings and profits, the amount distributed to a shareholder reduces the adjusted basis in his stock. If the S corporation has earnings and profits, the distribution is applied in the following order:

- (1) To the Accumulated Adjustments Account (AAA), which basically includes the income during the period the corporation has been an S corporation reduced by its losses and distributions during that period. The AAA for State income tax purposes does not include the federal AAA for tax years beginning prior to January 1, 1989. The shareholder does not take into account distributions from the AAA in determining taxable income but such distributions reduce the adjusted basis of his stock.
- (2) To Earnings and Profits (E and P): An S corporation is not considered to have earnings and profits for State tax purposes for years in which it operates as an S corporation after January 1, 1989. The E and P account basically includes the earnings and profits on hand from the period the corporation was a C corporation; and for State tax purposes, the E and P account also includes the undistributed earnings and profits of the S corporation from tax years beginning before January 1, 1989, (the federal AAA that existed on the day North Carolina began to measure the S corporation shareholder's income by reference to the income of the S corporation). The amount distributed to the shareholder from the E and P account is taxed to the shareholder as a dividend. Since the State E and P account includes the federal AAA that existed prior to the change in State law taxing the S corporation income to the shareholders, State taxable income must be increased for any distributions from the federal AAA that existed prior to the law change.
- (3) To the basis of the shareholder's stock: Any excess over the shareholder's basis is taxed as a capital gain.

(b) A shareholder who makes an election for federal tax purposes to treat distributions from the S corporation as being paid first from earnings and profits may not make a different election for State purposes.

*History Note: Authority G.S. 105-131.6; 105-262;
Eff. June 1, 1990;
Amended Eff. June 1, 1994; June 1, 1993; February 1, 1991;
Pursuant to G.S. 150B-21.3A, rule is necessary without substantive public interest Eff. July 26, 2015.*