INDIVIDUAL INCOME TAX
CORPORATE FRANCHISE TAX
Banks S Corporation Conformity

	Yes	No
Separate Official Fiscal Note Requested		X
Fiscal Impact		
DOR Administrative Costs/Savings		X

January 24, 2001

Department of Revenue
Analysis of H.F. 67 (Abrams)/S.F. 284 (Rest)
And Identical Bill H.F. 119 (Harder)

	Revenue Gain or (Loss)			
	F.Y. 2002	F.Y. 2003	F.Y. 2004	FY2005
	(000's)			
Corporate Franchise Tax	($26,580)	($29,270)	($31,510)	($33,220)
Individual Income Tax	21,270	23,410	25,210	26,570
General Fund	($5,310)	($5,860)	($6,300)	($6,650)

Effective for tax years beginning after December 31, 2000.

EXPLANATION OF THE BILL

Current Law:

For federal tax purposes, banks have been allowed to elect S corporation status since 1997. Since 1999, banks are allowed S corporation treatment for Minnesota tax purposes, with two differences:
- The bank is subject to the corporate franchise tax.
- Shareholders are allowed a credit against the individual income tax equal to 80% of the corporate tax.

A 1998 Minnesota law change allowed shareholders of S corporation banks a subtraction equal to the federal income tax on their S bank income. The 1999 law changes allowed S corporation treatment for banks, with the two differences noted above. This treatment meant that the bank income would be taxable to the shareholders, and dividends paid to shareholders would not be taxed. The subtraction for federal income tax was repealed in 1999.

Proposed Law:

The bill would move the treatment of banks electing S corporation status to full conformity with the federal treatment by:
- Eliminating the corporate tax on S corporation banks.
- Eliminating the credit allowed to shareholders which is equal to 80% of the corporate tax.

REVENUE ANALYSIS DETAIL

- FDIC data for 1997, 1998, 1999 and 2000 were used for the estimate
- Income of banks that elect S corporation status is the product of the total assets of these banks multiplied by an assumed return on assets (ROA).
- As of the fall of 2000, a total of 197 Minnesota banks had converted to S corporation status. These 197 banks have assets of about $16 billion.
- Projections of the bank S corporation assets begins with $16 billion figure as of September 30, 2000, and include the growth in assets of banks that have already converted, plus some additional banks converting each year.
- The assumed ROA estimate is based on the average ROA of Minnesota banks that have converted to S corporation status during the last four years. This average is assumed to predict the income of electing banks in the future.
- Publicly-traded banks can not elect S corporation status.
- Banks that are not publicly traded hold about 500 bank charters. These banks have estimated assets of about $30 billion.
- Some of the potentially eligible banks are not all currently qualified to elect S corporation status. Banks that have planned to elect S corporation status have used varying lengths of time to eliminate the obstacles to conversion, such as having more than 75 shareholders.
- Past surveys by the Minnesota Banker's association indicate that some eligible banks have decided not to elect S corporation status.
- The marginal increase in the number of S corporation banks will decline from the marginal increases that have occurred thus far. Projections of future conversions are based on the patterns of conversions in two groupings of banks, large and small.
- Additional conversions are likely to occur after tax year 2004, but they do not affect the estimates for fiscal years 2002-2005.

Number of Taxpayer Affected: About 1,000 shareholders of S corporations in fiscal year 2002.

ADMINISTRATIVE/OPERATIONAL IMPACT

There will be no significant administrative or operational cost to the department in administering this bill.

Source: Minnesota Department of Revenue
Tax Research Division
http://www.taxes.state.mn.us/polic.html#analyses

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