

## **X. Qualified Subchapter S Subsidiaries**

### **1. Preliminary Statement**

The Federal Small Business Job Protection Act of 1996 allows S corporations to own qualified S corporation subsidiaries, (QSSS). The parent must elect qualified S corporation treatment for its one hundred percent (100%) owned subsidiary. For federal tax purposes, a QSSS is not treated as a separate corporation, but rather all the subsidiary's assets, liabilities, and items of income, deductions and credits are treated as those of the S corporation parent. (IRC Section 1361(b)(3)(A)). North Carolina follows the federal treatment for income tax purposes and recognizes all the income and expense items as belonging to the parent corporation. (Reference: North Carolina Technical Advice Memorandum dated August 1, 1997, Qualified Subchapter S Subsidiaries, (CTAM 97-13)).

### **2. Parent S Corporation Nexus**

All of the subsidiary's activities will be attributed to the parent for purposes of determining whether the parent is doing business in North Carolina.

### **3. Apportionment Factors**

The parent S corporation must aggregate and include the subsidiary's items of income, loss, and deductions before determining the parent's apportionable or allocable income. The parent S corporation must also include the subsidiary's property, payroll and sales in calculating its apportionment factors. The parent S corporation must use the same apportionment factor that was used to apportion the combined income of the parent and subsidiaries to determine its capital stock, surplus and undivided profits franchise tax base. The QSSS does not calculate an apportionment factor for income tax since its income is taxed at the parent level. However, it must calculate its apportionment factor using its own property, payroll, and sales to determine its capital stock, surplus and undivided profits franchise tax base.

### **4. Franchise Tax Returns**

Each QSSS doing business in this State and each parent S corporation doing business in this State must file a separate franchise tax return for each taxable period based on their own separate attributes. The assets, liabilities, income, deductions or credits of the parent and the qualified S corporation are not combined for this purpose. A franchise tax return must be filed even if the resulting liability is the minimum franchise tax.

### **5. Shareholders**

Shareholders in an S corporation parent with a QSSS doing business in this State must report income attributable to this State in accordance with Part 1A of Article 4 of Chapter 105 of the General Statutes.