Guideline: **3.1** **Subchapter S Corporations**

Issue Date: **12/90** **(Revised 4/99, 3/07, 12/08, 11/09, 12/14)**

Description

Subchapter S Corporations (S Corporations) are corporations that have elected to be taxed under Subchapter S of the Internal Revenue Code.[1] Under this provision of the tax code, a pro-rata share of the S Corporation's taxable income is "passed through" to its shareholders who report it on their personal tax returns. Sole-proprietorships' and partnerships' income is taxed the same way.

Analysis

The S-corporation's taxable income is calculated and reported on a corporate tax return that includes forms sent to the IRS and the shareholders showing the amount allocated to each shareholder's gross income. Generally no tax is paid at the corporate level.

According to the FCC, regulators generally permit recovery of taxes imposed on a utility's regulated operations regardless of ownership form. The FCC has clarified that Subchapter S corporations are allowed to include actual shareholder income tax liability in their revenue requirement and in their high-cost submissions.[2]

If regulated operations are included in a consolidated group's tax calculation, the tax for the regulated operations is determined separately.[3] This is necessary to assure there is no cross subsidization between regulated operations and non-regulated operations.

NECA will continue to follow the same practice it has been using to determine the allowed tax expense recovery. This practice determines the weighted effective tax rate for unseparated income based on the individual shareholders' effective tax rate on their share of the corporation's regulated' income before tax. The S Corporations' interstate income tax expense is included in the interstate revenue requirement. It is calculated by grossing up the interstate amount subject to tax gross-up with the shareholders' weighted effective tax rate.[4]

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[1] *See generally* IRC §§ 1361-1379.

[2] Letter from Carol Mattey, Deputy Chief, WCB to Richard Belden, USAC, WC Docket Nos. 10-90, 05-337, and 06-122; CC Docket No. 96-45, 29 FCC Rcd 4971 (2014)

[3] *See, e.g.*, 47 C.F.R. § 32.27(e) and (f): "Income taxes shall be allocated among the regulated activities of the carrier, its nonregulated divisions, and members of an affiliated group. Under circumstances in which income taxes are determined on a consolidated basis by the carrier and other members of the affiliated group, the income tax expense to be recorded by the carrier shall be the same as would result if determined for the carrier separately for all time periods. . . "

[4] Companies will be required to provide documentation that supports the calculation of the composite shareholder(s)' / partner's tax rates (See attachment A for an example). Individual shareholder's / partners' rates should be based on the amount of their pretax income from the pass through entity's regulated operations. Companies unable or unwilling to provide documentation to support the composite effective tax rate will be required to use as a default the lowest individual federal and state rate in the individual federal and state tax tables.

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The S Corporation, like any rate base regulated entity, is required to maintain a reserve for deferred taxes in Account 4340, Net non-current deferred operating income taxes for inclusion in interstate cost studies and USF.

Conclusion

NECA will reimburse S Corporations for the interstate portion of federal and, where applicable, state income taxes as discussed above. The treatment applies to any pass through entity type that has an actual tax liability. It includes sole-proprietorship, and Partnerships, S-corporations and Limited Liability Companies classified as any of these.

The Federal Communication Commission (FCC) has authorized NECA to interpret FCC Rules where necessary.[5] Pursuant to this authorization, NECA has published this Reporting Guideline Paper. Notwithstanding NECA's recommended interpretation, the FCC retains the full authority to review NECA's Reporting Guideline Papers. In the event of such review, the FCC's findings, if contrary to NECA's position, will take precedence.

[5] *Safeguards to Improve the Interstate Access Tariff and Revenue Distribution Processes*, CC Docket 93-6, Report and Order to Show Cause, 10 FCC Rcd. 6243 (1995)

Guideline: 3.1 Subchapter S Corporations

Attachment A

COST ISSUE 3.1 ATTACHMENT A for **2008**
WORKSHEET FOR DETERMINING
THE ESTIMATED EFFECTIVE
FEDERAL INCOME TAX RATE & USF TAX EXPENSE
FOR ENTITIES NOT SUBJECT TO A CORPORATE FEDERAL INCOME TAX

Study Area:
INITIALS:
DATE:

Attachment A produces two results. It produces a tax rate for the interstate tax allowance calculation, based on stand-alone regulatory operations, and a total tax expense for USF (green cells). A minimal amount of input is required (blue shaded cells). It is designed to calculate the federal income tax expense. State income tax expense must be separately calculated for individual owners. **See additional input instructions.**

1	TOTAL COMPANY AVERAGE NET INVESTMENT (See note 1)	
2	TOTAL COMPANY ACTUAL RATE OF RETURN (See note 2)	(enter as percent)
3	RETURN (LN 1 x LN 2)	-
4	FIT INCOME ADJUSTMENTS (NECA Allocator)	
5	INVESTMENT TAX CREDIT AMORTIZATION (NECA Allocator)	
6	**SUBJECT TO TAX GROSS-UP**	-

Total Company	
Reg. rev.	
Reg exp.	
Oper. Inc.	-
FIT Adjs.	-
Taxable Inc.	0

(See notes 3 &

			Shareholder	Shareholder	Shareholder	Shareholder	Shareholder	Shareholder	Total Shareholder
7	AFTER TAX ADJ INCOME (Lines 3-4-5)		-	-	-	-	-	-	-
		Ownership							0.00%
8	FEDERAL INCOME TAX		-	-	-	-	-	-	-
9	TAXABLE INCOME (LINE 6 + LINE 7)		0	0	0	0	0	0	0
		Grossed up							
10	FIT ON $0 to $8024 @ .10	0.111111111	0	0	0	0	0	0	0
11	FIT ON $8025 to $32549 @ .15	0.176470588	0		0	0	0	0	0
12	FIT ON $32550 to $78849 @ .25	0.333333333	0	0	0	0	0	0	0
13	FIT ON $78850 to $164549 @ .28	0.388888889	0	0	0	0	0	0	0
14	FIT ON $164550 to $357699 @ .33	0.492537313	0	0	0	0	0	0	0
15	FIT ON $357700 to $$$$ @ .35	0.538461538	0	0	0	0	0	0	0
16	TOTAL FIT BEFORE TAX CREDITS (LINES 10 to 15)		-	-	-	-	-	-	-
17	ESTIMATED EFFECTIVE FIT RATE (LINE 16/LINE 9)		0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%

Note (1) Total company refers to total regulated operations.
Note (2) Regulated net income divided by total company average net investment.
Note (3) Additional shareholders can be added in columns M-AH.
Note (4) If total is not 100% and red, check ownership % entries.

Docket No. 16-0378
IITA Exhibit 1.13