Revenue Ruling No. 06-010
June 30, 2006
Corporate Franchise Tax

R.S. 47:605.1's Fifty Percent Excess Rule and its Implementation

Purpose

The purpose of this Revenue Ruling is to provide guidance to Revenue employees and taxpayers in determining the proper way to include fifty percent of a corporation's debt to related parties in the capital stock and surplus and undivided profits of that same corporation.

Background/Analysis

Revised Statute 47:605.1 states that if a corporation's total debt to related parties exceeds the capital stock, surplus and undivided profits of the corporation as determined under R.S. 47:604 and 605, then 50% of the amount of the excess shall be included in the capital stock, surplus and undivided profits of the corporation. The term debt can not include trade debt that is less than 180 days old, deposit liabilities to related parties or be reduced by receivables. "Related parties" mean any member of a controlled group of corporations as defined in 26 U.S.C. § 1563 or any other person that would be a member of a controlled group if rules similar to those of 26 U.S.C. § 1563 were applied to that person. The difficulty in implementing this fifty percent excess rule arises in some situations when the corporation's capital stock and surplus and undivided profits account carries a negative number.

Ruling

When both the corporation's debt to related parties and its capital stock, surplus and undivided profits are positive numbers, half of the excess debt to related parties will be included in the capital stock, surplus and undivided profits of that corporation.

Example 1: A Corporation's debt to related parties equals $100,000 and its capital stock, surplus and undivided profits equals $50,000. The difference in the debt to related parties and the corporation's capital stock, surplus and undivided profits is $50,000. Fifty percent of the difference or $25,000 will be transferred from related party debt to A Corporation's capital stock, surplus and undivided profits. After the transfer of half the related debt, the account balances will be $75,000 in related party debt and $75,000 in capital stock, surplus and undivided profits.

When the corporation's debt to related parties is a positive number and its capital stock, surplus and undivided profits is a negative number, half of the debt to related parties in excess of the capital stock, surplus and undivided profits will be included in the capital stock, surplus and undivided profits of the corporation to the extent that the corporation's debt does not fall below zero.

Example 2: B Corporation's debt to related parties equals $75,000 and its capital stock, surplus and undivided profits equals ($25,000). The difference in B Corporation's related party debt and its capital stock, surplus and undivided profits is $100,000. Fifty percent of the difference or $50,000 will be transferred from B Corporation's related party debt to its capital stock, surplus and undivided profits. After the transfer of half of the related debt, the account balances with be $25,000 in related party debt and $25,000 in capital stock, surplus and undivided profits.

Example 3: C Corporation's debt to related parties equals $25,000 and its capital stock, surplus and undivided profits equals ($75,000). The difference in C Corporation's related party debt and its capital stock, surplus and undivided profits is $100,000. Normally, fifty percent of the difference or $50,000 would be transferred from C Corporation's related party debt to its capital stock, surplus and undivided profits. In this case, transferring the entire $50,000 would make the related party debt a negative number. Instead, only $25,000 will be transferred from related party debt to C Corporation's capital stock, surplus and undivided profits leaving balances of $0 in related party debt and ($50,000) in capital stock, surplus and undivided profits.

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