

Presenting a live 110-minute teleconference with interactive Q&A

S Corporations: Special Tax Challenges

Confronting the Key Issues of Basis Rules, Business Structure,
Payroll-Taxable Wages, Contributions and Distributions

TUESDAY, JUNE 26, 2012

1pm Eastern | 12pm Central | 11am Mountain | 10am Pacific

Today's faculty features:

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**S CORPORATIONS:
SPECIAL TAX
CHALLENGE
TUESDAY, JUNE 26**

By

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REQUIREMENTS OVERVIEW

Presented By: Robert Barnett

S CORPORATION REQUIREMENTS

- Domestic corporation (or association taxed as a corporation)
- Not ineligible
- Form 2553 (2 ½ months)
- No more than 100 shareholders
- Custodial Account permitted
- Individual, Estate, Certain Trusts
- No nonresident alien
- One class of stock – voting differences OK

REQUIREMENTS OVERVIEW

- PLR 201017031
 - Employment agreement did not create second class of stock
 - Agreement was not entered in order to circumvent the single class of stock requirement
 - A commercial agreement or employment agreement **DOES NOT** relate to liquidation proceeds

SHARES HAVE IDENTICAL RIGHTS.

REQUIREMENTS OVERVIEW

- S Election – Many private rulings to correct
- PLR 201216016 – failed to timely file 2553
- PLR 201216030 – ineligible shareholders
- PLR 201119005 – separate Trust shares treated as separate Trust – QSST election available but all income must be distributed currently
- PLR 201216015 late QSUB – Form 8869

S CORPORATION REQUIREMENTS

- Debt/Equity – debt can cause second class of stock
- May be taxed at highest corporate rate (or lose S status after 3 years)
- If excess Passive Income & E & P
- Special elections available to strip out E & P
- **MOTTO:** be an S Corp from the beginning

SHAREHOLDER ELIGIBILITY: TRUSTS

- **Protect S Corp Status**
- Grantor Trusts
- Testamentary trusts for 2 years after stock transferred to trust
- QSST's
- ESBT
- Voting trusts – all members counted as shareholders – must be eligible
- § 645 election for QRT for allowed term

QSST

- Must meet IRC Sec. 1361 requirements
- **ONE** current income beneficiary (husband & wife file joint returns- may treat as ONE beneficiary **IF** both signed election)
- **ALL INCOME** distributed to beneficiary at least annually
- Corpus distributions **only** to beneficiary
- Termination during beneficiary's life – trust must provide that all income and corpus distributed to beneficiary

QSST ELECTION

- Election must be made by current income beneficiary – treated as “owner”
- Form 2553 if stock transferred to trust on or before date corporation makes S Corp election
- If Form 2553 cannot be used – file statement with IRS service center where corporation files federal income tax return
- Revocation with IRS consent only

QSST TAX CONSEQUENCES

- S portion treated as grantor trust
- Beneficiary is taxed as S Corp shareholder – even if income not distributed to trust
- If trust sells S Corp Stock
 - QSST election terminates with respect to stock sold
 - Trust recognizes gain/loss, not beneficiary

LOSS OF QSST STATUS

- QSST ineligible to hold S Corp stock as of date it fails to meet requirements
- If trust becomes ineligible at income beneficiary's death, trust can hold S Corp stock for **2 years** after income beneficiary's death
 - Income Beneficiary's Estate is treated as shareholder

EXAMPLE

- A is sole income beneficiary of Trust X. On A's death, income is to be paid in Trustee's discretion to either B or C during their lives, with all income paid to survivor. A files QSST election. During A's life, X is a QSST. On A's death, if both B and C survive A, X will no longer be a QSST.
- If B or C (but not both) died before A, X should continue to be a QSST after A's death since it would have only one current income beneficiary.

ESBT

- Trustee makes election
- Meet IRC Sec. 1361 requirements
- Beneficiary must be permitted S Corp Shareholder
- Can have more than one Beneficiary
- Can retain or sprinkle income
- No current distribution requirement
- Treat portion of trust containing S Corp stock as a **SEPARATE TRUST**

TAX ON SEPARATE TRUST

- Trust taxed on S Corp items at the highest trust rate unless maximum capital gains rate applies.
- S Corp Separate Trust taxable income computed:
 - Items of income, deduction, loss or credit as an S corporation shareholder
 - Gain/Loss from disposition of S corporation stock;
 - Deduct State or local income taxes and administrative expenses allocable to above; and
 - Interest expense that is paid or accrued on debt incurred to acquire S corporation stock

TRUST RULINGS

- PLR 201108012 – ESBT election allowed for Trust ineligible for QSST
- **PLR 201122003** Separate Trust shares – beneficiary can make QSST election & revoke prior ESBT election

SECTION 83

Presented By: Renato Matos

IRC §83(a)

- Excess of FMV of Property Transferred over Amount Paid (if any)
- In connection with the Performance of Services
- Is included in Gross Income as compensation of the person performing the services as employee or independent contractor

IRC §83(a) CONTINUED

- In the first taxable year in which the property becomes **SUBSTANTIALLY VESTED** – the rights of the person having the beneficial interest in such property
 - ARE TRANSFERABLE (is transferee required to forfeit), **OR**
 - Are NOT subject to a **SUBSTANTIAL RISK OF FORFEITURE** – whichever is applicable

TREAS. REG. 1.83-1(a)

- Property is NOT TAXABLE – until the employee acquires a BENEFICIAL OWNERSHIP INTEREST in such property AND it has become SUBSTANTIALLY VESTED
 - Until such property becomes substantially vested, the TRANSFEROR (employer) shall be regarded as OWNER of such property AND
 - Any income from such property received by the employee shall be included in the gross income of such employee as ADDITIONAL COMPENSATION for the taxable year received, and DEDUCTIBLE by the corporation
 - Holding period begins at the time the interest is vested

§83(b)

- Permits any person performing services
 - TO ELECT to include in income in the taxable year in which the property is transferred (even though non-vested)
 - No compensation is included in income when vesting occurs
 - Subsequent appreciation is considered Capital Gain

RESTRICTED STOCK

- Treas Reg. 1.1361-1(b)(3)
 - Restricted stock which is substantially **NONVESTED** is treated as NOT OUTSTANDING
 - Holder is **NOT** treated as a shareholder
 - If §83(b) election is timely made
 - Holder is treated as the shareholder for purposes of Subchapter S
 - Such stock is not treated as a second class of stock if it confers identical distribution and liquidation rights

PROPOSED REGULATIONS

- Apply to transfers after 12/31/2012
- Limit tax deferral
- Substantial risk – forfeiture must be a service condition or related to the purpose of the transfer
 - Likelihood of forfeiture is relevant
 - Likelihood of enforcement is relevant
 - Transfer restriction is not sufficient

US v. FORT

107 AFTR 2d (11th Cir. 2011)

- CAP GEMINI shares were received by E&Y partners on 5/23/2000
- Certain restrictions applied – FORT reported \$1,759,097 in income in 2000 (\$156/share) – shares drop in value
- FORT is terminated by E&Y in 2003 and amends his prior return
- Gov't refunds and sues to recover
- **Issue** – Constructive Receipt

PHANTOM STOCK

- Treat deferred amounts “as if” invested in shares of own stock, stock of other corporations or in other assets
- Shares NOT bought in employee's name or set aside in an escrow or trust arrangement for employee
- Until employee receives payment, stock is merely a device for measuring value of deferred compensation

EXAMPLE

B corporation pays E, employee, a bonus of \$20,000, which E defers. B's stock is traded at \$20/share currently. E is credited with 1,000 shares of phantom stock. During deferral period, B pays a total of \$12 in dividends/share, and credits E with \$12,000. At the end of the deferral period, B stock is traded at \$48/share and E is paid a total of \$60,000 (value of phantom shares, \$48,000, plus earned dividends, \$12,000)

S SUBSIDIARIES

Presented By: Renato Matos

S SUBSIDIARIES

- S Corporation subsidiary
- A QSSS Election is available for 100% owned subsidiary
- Form 8869 and NYS CT-60
- Deemed liquidation §332
- Consider for Brother/Sister groups
- Effective – asset protection & loss utilization

S SUBSIDIARIES

- Does not change BIG holding period
- Good for loss utilization (or 1031 exchange)
- **CCA 201114017** does not increase S Corporation shareholders' stock basis
- §332 is a tax-free liquidation – mere change of form and does not provide increased basis

TERMINATION OF QSUB

- Treated as new corporation
- Issue subsidiary stock for assets
- TAX FREE IRC §351
- Requires parent control (80%)

2007 LAW CHANGE

- Treatment of sale of QSUB Interest
- Parent sells 21% - **QSUB TERMINATES**
- SUB is new Corp, but will not qualify for §351
- 21% of Gain is recognized
- Step transaction may apply

FORM 8869

Form **8869**
(Rev. December 2008)
Department of the Treasury
Internal Revenue Service

Qualified Subchapter S Subsidiary Election

OMB No. 1545-1700

(Under section 1361(b)(3) of the Internal Revenue Code)

Part I Parent S Corporation Making the Election

1a Name of parent	2 Employer identification number (EIN)
b Number, street, and room or suite no. If a P.O. box, see instructions.	3 Tax year ending (month and day)
c City or town, state, and ZIP code	4 Service center where last return was filed
5 Name and title of officer or legal representative whom the IRS may call for more information	6 Telephone number of officer or legal representative ()

Part II Subsidiary Corporation for Which Election is Made (For additional subsidiaries, see instructions.)

7a Name of subsidiary	8 EIN (if any)
b Number, street, and room or suite no. If a P.O. box, see instructions.	9 Date incorporated
c City or town, state, and ZIP code	10 State of incorporation
11 Date election is to take effect (month, day, year) (see instructions) ▶ / /	
12 Did the subsidiary previously file a federal income tax return? If "Yes," complete lines 13a, 13b, and 13c ▶ <input type="checkbox"/> Yes <input type="checkbox"/> No	
13a Service center where last return was filed	13b Tax year ending date of last return (month, day, year) ▶ / /
13c Check type of return filed: <input type="checkbox"/> Form 1120 <input type="checkbox"/> Form 1120S <input type="checkbox"/> Other ▶	
14 Is this election being made in combination with a section 368(a)(1)(F) reorganization described in Rev. Rul. 2008-18, where the subsidiary was an S corporation immediately before the election and a newly formed holding company will be the subsidiary's parent? ▶ <input type="checkbox"/> Yes <input type="checkbox"/> No	
15 Was the subsidiary's last return filed as part of a consolidated return? If "Yes," complete lines 16a, 16b, and 16c ▶ <input type="checkbox"/> Yes <input type="checkbox"/> No	
16a Name of common parent	16b EIN of common parent
16c Service center where consolidated return was filed	

Under penalties of perjury, I declare that I have examined this election, including accompanying schedules and statements, and to the best of my knowledge and belief, it is true, correct, and complete.

Signature of officer of parent corporation ▶	Title ▶	Date ▶
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CONTRIBUTIONS

A. Basis Tracking and Loss Utilization

Presented By: Robert Barnett

BASIS TRACKING

- Stock Basis begin with purchase
- Increase by K-1 income items & tax free income
- Pro rata – per share per day
- Decrease (**not below 0**) k-1 losses & distributions
- Compute at close of year (or before disposition)

BASIS TRACKING

- Contribute property – basis is less liability assumed, **WATCH §357(c)**
- **EXAMPLE:** Property Basis \$40,000, Value \$100,000 and mortgage of \$30,000 is contributed for **STOCK – BASIS \$10,000**
- Special Estate Considerations – reduction for IRD type items
- Ordering Rules – will be discussed

LOSS UTILIZATION

- **IRC §1366(d)(1)** determines deductibility of losses and deductions – limits use of S Corp losses and deductions to extent of shareholder's basis in stock PLUS Corporate debt to shareholder. **Basis determines:**
 - Deductibility of losses and deductions
 - Taxability of distributions
 - Gain/Loss on sale of stock
- Contribution to Capital raises Stock Basis
- **WATCH AT RISK REQUIREMENTS**

LOANS

- Assume Stock Basis \$100
- If X \$200 loss, shareholder deducts only \$100
- §1366(d)(1) deductions limited to Basis
- **Basis can never be negative**
- So shareholder loans \$100 to Corp on 12/31
- Stock Basis & Loan Basis is **\$0**
- Later income first restores Loan Basis

LOSS UTILIZATION

- How is Basis Created?
 - Contribute cash or property (less liability assumed)
 - KEEP RECORDS & RETURNS**
 - Accumulated and undistributed corporate income
 - Income exempt from tax
 - For purpose of computing limits for loss deductions - also look at basis of corporate debt to shareholder
 - Reduced by distributions losses and nondeductible expenses
 - ***BARNES*, TCM 2012-80** – reduce basis even if fail to deduct the loss

LOSS UTILIZATION

- *Gleason v. Commissioner*, TCM 2006-191 (9/11/06)
 - Taxpayer won as the borrower on a \$6m loan
 - IRS went out of its way to re-characterize a loan properly made by the taxpayer, because payments on the loan were being made by the corporation and stock was pledged as collateral
- *Kerzener*, TCM 2009-76
 - **CIRCULAR LOAN** from partnership to S shareholder to S corp did not create basis.
 - S Corp paid equivalent rent back to the partnership.
 - Transaction **lacked economic substance**
 - **MERE CONDUIT** – No sufficient risk
 - Court distinguished Ruckriegel and Culnen
- *Nathel*, 105 AFTR 2 ¶ 2010-927 (2nd Cir. 6/2/10)
 - Equity and debt are distinguishable
 - Contribution of equity increases the basis of stock but does not restore loan basis
 - **CONTRIBUTIONS TO CAPITAL ARE NOT INCOME!**

Culnen, TCM 2000-139

- The Tax Court approved taxpayer's position that distributions from profitable S corporation (over \$3 million) to loss corporation were added to his basis because
 - i. the amounts came out of S earnings,
 - ii. were always shown on the corporations books as loans to/from shareholder, and
 - iii. all bank financing statements showed the loans as personal not corporate.
- **IRS reviewing Back to Back loans**

CONTRIBUTIONS

B. Related Entities

Presented By: Robert Barnett

RELATED ENTITIES

- Weekend Warrior Trailers Inc.
- S Corp to S Corp management fees denied
- Lack of economic substance – entities formed for tax purposes
- Burden of Proof – on taxpayer (IRS had burden to prove increased deficiency – IRS disallowed 100% of fees)
- Taxpayer said valid business purpose

RELATED ENTITIES

- Court said sufficient business activity but management fees NOT supported
- **20% penalty** – negligence, disregard or substantial understatement
- Understatement greater of 10% of tax or \$5,000
- BOP of production on commissioner
- Then BOP shifts to Taxpayer for reasonable cause
- Reliance on tax professional not an absolute defense

§481 ADJUSTMENTS

- *BOSAMIA v. COMM.* (5th Cir. 2011)
- Two S Corporations – one **INVENTORY ACCRUAL METHOD**
- Purchased from other S Corporation – **CASH METHOD**
- No payments were made – common control
- Deduction **denied** – §481 adjustment

CONTRIBUTIONS

C. Open Account Debt

Presented By: Robert Barnett

OPEN ACCOUNT DEBT

- *Brooks v. Commissioner* – TCM 2005-204
(August 25, 2005)
- **Proposed Regulations**

LOANS

- Assume Stock Basis \$100
- If X \$200 loss, shareholder deducts only \$100
- §1366(d)(1) deductions limited to Basis
- **Basis can never be negative**
- So shareholder loans \$100 to Corp on 12/31
- Stock Basis & Loan Basis is **\$0**
- Later income first restores Loan Basis

OPEN ACCOUNT DEBT

- Shareholder loans/advances not evidenced by written instrument
- New Regulations – advances 10/20/08 and thereafter
- Limit \$25,000 per Shareholder
- **EXAMPLE** – 10 Shareholders, each can have up to \$25,000 of Open Account Debt

BE CAREFUL

- No single Shareholder exceeds limit
- Keep records per Shareholder
- Not day/day – END OF S YEAR
- Unless debt disposed or Shareholder terminated

WHAT HAPPENS

- When \$25,000 limit exceeded
- Debt at end of year treated **AS IF**
- Evidenced by separate written agreement
- No longer Open Account Debt
- Debt existing on 10/20/2008 is not subject to new rules and is treated as a separate loan
- Identification issues exist

LOSSES – ORDERING RULES

- Losses first absorb Stock Basis
- Then reduce Debt Basis
- **NOT BELOW ZERO**
- Multiple indebtedness – Loss Allocated
- Based upon aggregate Basis
- Intricate record keeping required

RESTORATION

- Distinction between Stock & Debt Basis
- “Net Income” restores Debt Basis first
- “Net Increase” is §1367(a)(1) income items
- New contributions increase Stock Basis
- *Nathel*
- Computations generally determined at end of the year

COMPUTATION

- Advances and Repayments are netted
- At close of S Corp year
- Net Advance or Repayment is combined with Principal balance of Open Account Debt
- Carried to next year (unless $> \$25,000$)
- IF $> \$25,000$ – no longer Open Account Debt
- Treated as separate debt – evidenced by a note

REPORTING REQUIREMENTS

- Must keep records per shareholder
- IF hold more than one indebtedness at close of year –
 - Basis is reduced proportionately to aggregate Basis
 - Net increase is applied to first restore debt basis before stock basis
 - First restore Basis of any debt which is repaid during year

EXAMPLE ONE

- A's Stock Basis is \$0
- 6/1/09 A loans S \$16,000 (no note)
- 12/31/09 – Open Account Debt = \$16,000

EXAMPLE TWO – 2009

STOCK BASIS \$0

- A lends \$16,000 6/1/09
- 12/31/09 Loss <\$8,000>
- A's BASIS in Open Account Debt is \$8,000
- Principal loan amount remains \$16,000

EXAMPLE THREE – 2010

- A Stock Basis = \$0 Loan Basis = \$8,000
(principal \$16,000)
- 4/1/10 – S Repays to A \$4,000
- 9/1/10 – A Advances \$1,000 (net \$3,000)
- 12/31/10 – Debt Principal \$13,000
- Still open Account Debt

EXAMPLE THREE CONTINUED

- A recognizes ordinary income \$1,500
($8/16 \times \$3,000$ Net Repayment)
- IF evidenced by a note gain is Capital Gain
(note: Tax treatment of debt treated “as if”
evidenced by a note is not yet addressed)
- 12/31/10 – Open Account Debt Principal
\$13,000
- Carried to 2011

EXAMPLE FOUR (ex. 3 FACTS)

- 2/1/11 – S Repays A \$5,000
- 3/1/11 – A Advances \$20,000
- Not evidenced by a written agreement
- 2011 Net Advance \$15,000
- Debt \$28,000 ($>$ \$25,000 – not Open Account Debt)
- Treated **as if** evidenced by a separate written agreement

WHO CARES?

- The IRS & the Treasury
- \$25,000 limitation eliminates Year End Repayments
- Mixed blessing
- Gain on Replacement of Debt evidenced by notes is **CAPITAL GAIN**
- Repayment of Open Account Debt with reduced bias = **ORDINARY INCOME**

FOREGONE INTEREST

- IRC §7872 requires imputed interest
- Re-characterizes below-market interest at AFR
- As if lender transferred \$ to Corp and Corp paid interest – or constructive dividend
- Transfer to Corp may be GIFT, CAPITAL, COMPENSATION

FORGONE INTEREST **continued**

- Demand vs Term Loan
- Factual Inquiry
- IRS asserted **constructive dividend** income to shareholder
- Loans shown Schedule L
- Therefore Burden of Proof shifts to shareholder

PAYROLL TAXABLE WAGES

Presented By: Renato Matos

EMPLOYMENT FACTORS

- Fact Sheet 2008-25 IRS WARNING
- Training and experience
- Duties and responsibilities
- Time and effort devoted to the business
- Dividend history
- Payments to non-shareholder employees
- Timing and manner of paying bonuses to key people
- What comparable businesses pay for similar services
- Compensation agreements
- Use a formula to determine compensation
- Rev. Rul. 74-44, 1974-1 CB 287

EMPLOYMENT FACTORS

- *Donald G. Cave Professional Law Corp* 109 AFTR 2d ¶ 2012-609 (5th Cir 2012) TCM 2011-48
 - Law firm S Corporation – personal injury firm
 - Issue was whether President (sole shareholder) and law clerks were independent contractors
 - Associates were not required to work in the office, they set their hours, no employment or noncompetition agreement

EMPLOYMENT FACTORS

- Associates paid 1/3 of fees collected or 1/2 if they originated the matter
- No vacation, benefits, etc.
- Taxpayer asserted insufficient control
- IRC §3121(d)(1) and §3306(1) – officer who performs substantial services and receives remuneration is employee
- Associates and Clerk were also employees

EMPLOYMENT FACTORS

- **FACTORS** – Hired by employer, assigned tasks, Degree of control (Professional Services less control required), Investment in tools and facilities, Profit or loss (they had no risk of loss), Permanence of relationship, Skill required (these were inexperienced associates), Integral part of the business, Worked exclusively for taxpayer
- §503 relief **NOT** available
 - No reasonable basis (although this was a consistent practice)

WATSON

- *Watson v. U.S.*, 105 AFTR 2d ¶ 2010-908 (Dist. Ct. IA 5/27/10), aff'd 8th Cir. 2/21/12
 - Watson took \$24,000 salary, and an additional \$203,651, of which \$118,159 were treated as dividends
 - IRS said dividends should be wages!
Assessed \$48,519 in tax **and penalty**
 - IRS warned S corporations not to avoid payroll taxes
 - Rev Rul. 74-44

DAVIS

- Davis v US, 74 AFTR2d 94-5618 (D. Colo.1994).
- Shareholders had minimal participation in day-to-day operations
 - One shareholder worked about 12 hrs/month
 - Other shareholder worked for other companies
- Court found IRS assessment was arbitrary and capricious and was not substantially justified

RYAN

- *Ken Ryan, Inc., v. Commissioner*, TC Summary Opinion 2010-18 (2/23/2010)
 - Accountant recorded salary in journal
 - IRS asserted 941 penalties on transfers during the year
 - **NO PENALTY** – negligence penalty requested by IRS, but close call

DISTRIBUTIONS

Presented By: Renato Matos

DISTRIBUTIONS

- Occur on date corporation makes the distribution
- **NO E & P**
 - tax free to stock basis
 - excess cap gain §1368(b)(2)
- **MOTTO**: Avoid C Corp. E & P

E & P – MULTIPLE CONSIDERATIONS

1. Tax Free to extent of AAA & Basis
 2. Capital Gain extent of AAA > Basis
 3. Dividend to extent of corporate E & P > AAA
 4. Tax Free (IF remaining Basis in stock)
 5. Capital Gain thereafter
- AAA is a corporate level item, tracks undistributed **S income and Expenses** similarly to basis except with respect to tax exempt items

ELECTION – TREAS. REG. §1.1368-1

- S Corp may elect to distribute E & P first **OR**
- To make a deemed dividend

ORDERING RULES

- Income increases Basis before distributions
- Losses are considered after distributions

EXAMPLE – X CORP

- Shareholder Basis \$100
- X \$500 income distributes \$400 to shareholder
- Basis increases to \$200

- Alternative: **IF X DISTRIBUTED**, Capital Asset FMV \$400 Basis \$100
- X Corp recognizes \$300 income Pass Thru
- Basis increases to \$500 (\$100 + \$300 PLUS income \$500 – Distribution \$400)

CHARACTER OF GAIN

- §311(b)(1) Gain 400-100 Basis
- If depreciable property, §1239 OI
- Otherwise K-1 shows Capital Gains
- The distribution of the capital asset was tax free, as there was sufficient basis

IRC §469

- Distributions from S Corp > Basis
- No E & P
- Capital Gain recognized
- May be considered **PASSIVE INCOME**

ELECTION TO TERMINATE YEAR

Presented By: Robert Barnett

INCOME ALLOCATIONS

- S shareholders – report pro rata share
- Separate treatment of certain items
ex. Contributions, Capital Gains
- Nonseparate reporting of corporate net income
- §1377 – Daily allocation

EXAMPLE

(A + B are Equal Shareholders)

- X profit \$100 to 6/30 Loss \$200 12/31
- B sells his 50% interest to C on 6/30
- B's K-1 ?
- C's K-1?

EXAMPLE CONTINUED

- No terminating election §1377(a)(2)
- X loss \$100 – A <50>; B <25>; C <25>
- If election (consider sale of assets):
- A <50>; B + 50 income; C <100>

ELECTION TO TERMINATE YEAR

- *If shareholder's* **entire interest** is terminated
- Corp & all affected shareholders agree
- Corp may elect to close taxable year
- 1st year ends at close of day – on which interest is terminated
- **IRREVOCABLE**
- May protect Selling Shareholder

ELECTION CONTINUED

- Affected shareholders – terminated shareholders
- All shareholders receiving the shares
- If redemption – then all shareholders during year
- Use normal method of accounting

ELECTION CONTINUED

CONSIDER WHEN:

- Sale
- Exchange
- Gift
- Redemption
- Spousal Transfer §1041

ELECTION –

See Reg. §1.1377-1(b)(5)

- Statement – timely filed return
- May file single statement for all terminations during year
- Declaration of electing to close books
- Information regarding shareholder termination
- All affected shareholders must consent

ESTATE TAX TRAP

Presented By: Robert Barnett

DISSOLUTION UPON SALE BY ESTATE

- Liquidate in **SAME** year as sale

Example: D's estate S Corp stock basis = \$100.
S Corp assets FMV \$100, basis \$10.

- S Corp sells assets= \$90 gain (\$100 FMV - basis \$10).
- Shareholder basis in stock \$100 plus \$90 = \$190
- Shareholder liquidates immediately- offset \$90 gain with \$90 loss on liquidation.
- QSST- loss on liquidation recognized by trust

ESTATE BASIS

- Inherited stock IRC §1367(b)(4)
- Step-up rules of §1014
- Then reduce basis by IRD §691 type items at the S Corporation level
- **Example:** Unrealized receivables and installment sale items