

Chapter 5: Corporations

Menard v. Comm'r

\$20 million

is

Reasonable Comp

5-1

Reasonable Comp

7th Circuit:

“Independent Investor” Test

Exacto Spring Corp v. Comm'r

5-1

Reasonable Comp

9th Circuit:

Elliotts Inc. v. Comm'r

Multi-Factor Test

5-2

Elliotts Inc. Factors:

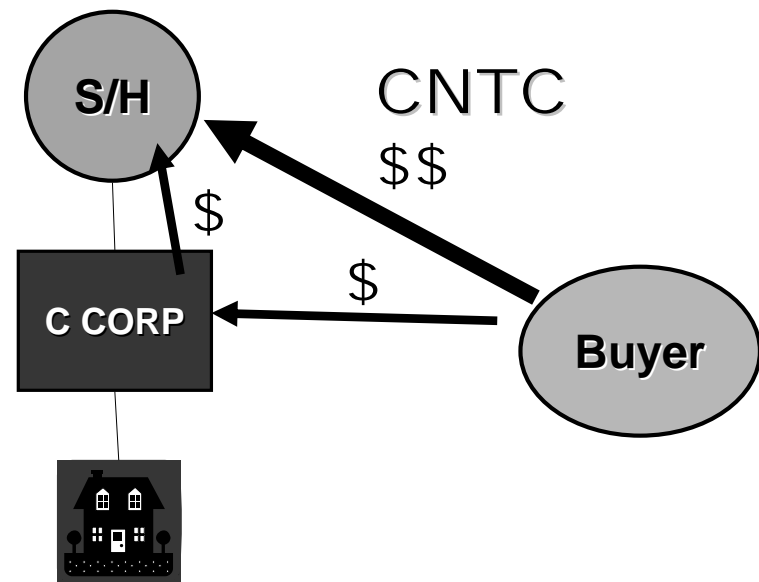
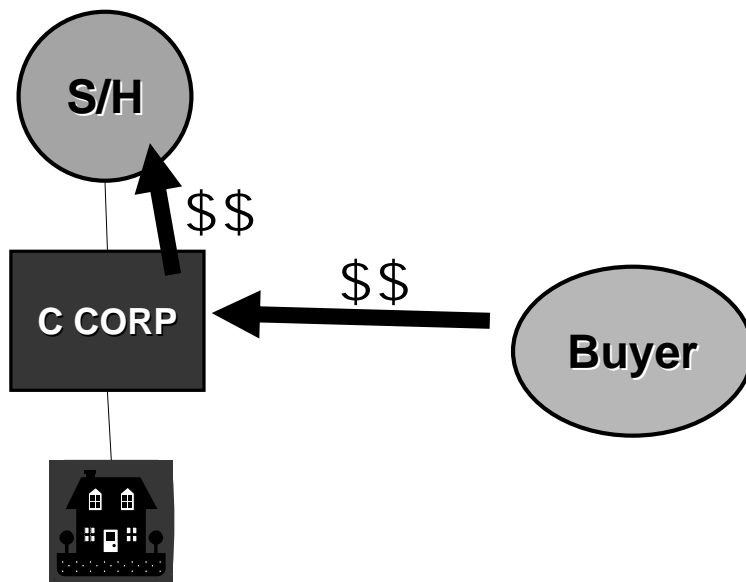
- *Role of Employee*
- *Comps from Other Companies*
- *Condition of Company*
- *Independent Investor Test*
- *Internal Consistency*

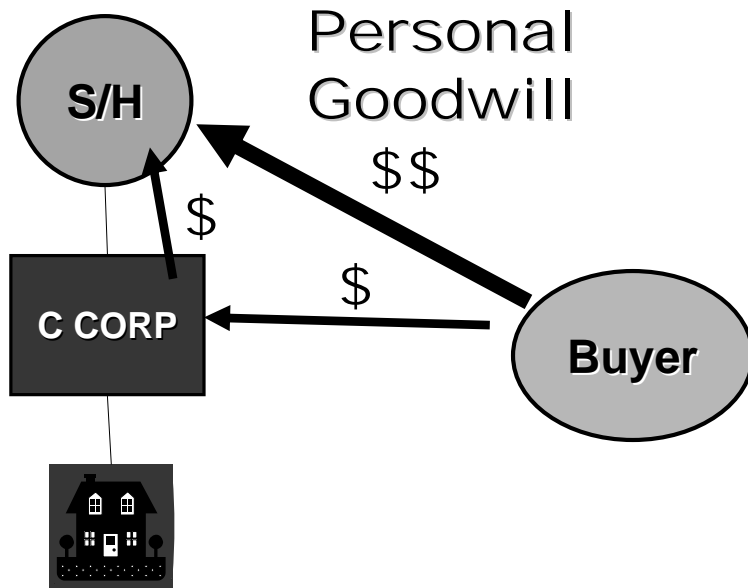
5-2

Muskat v. Comm'r.

*Another
Failed Attempt at
Personal Goodwill*

5-6





Martin Ice Cream Co.
v.
Comm'r

Norwalk
v.
Comm'r

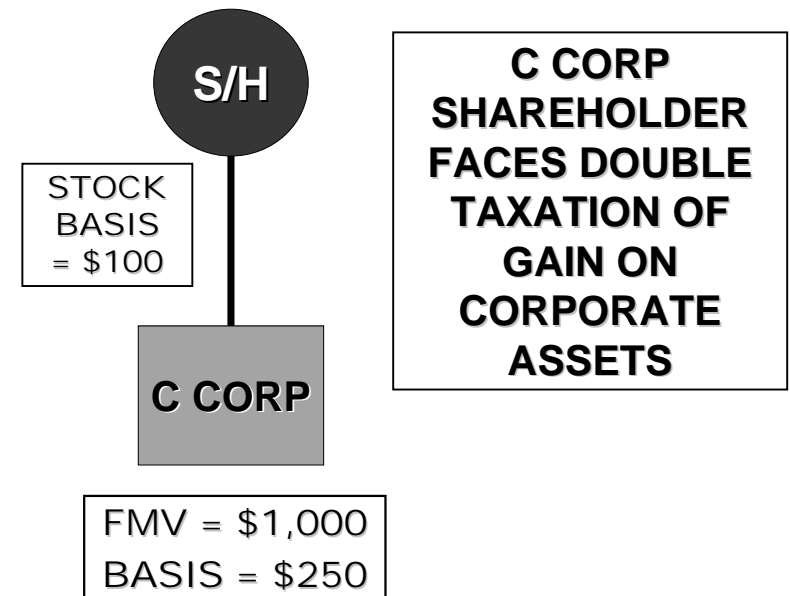
5-7

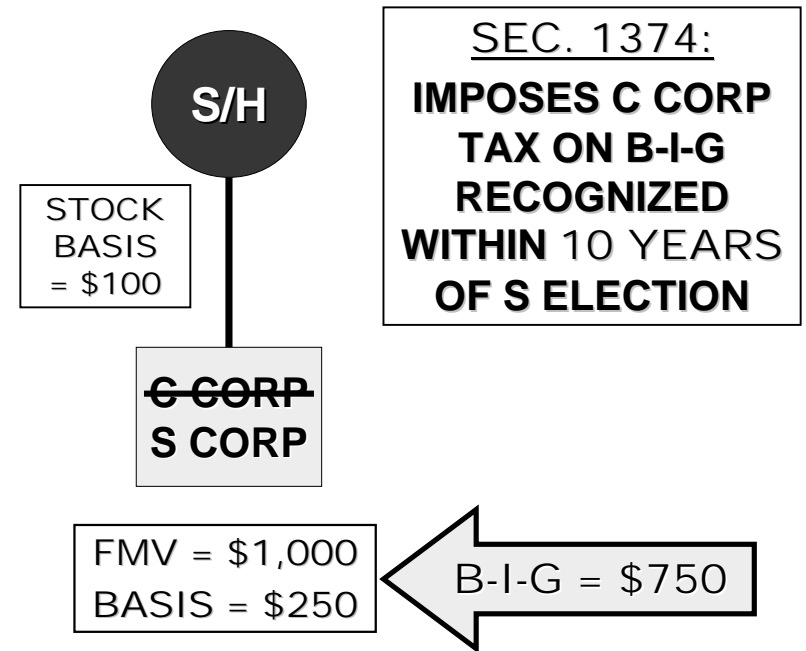
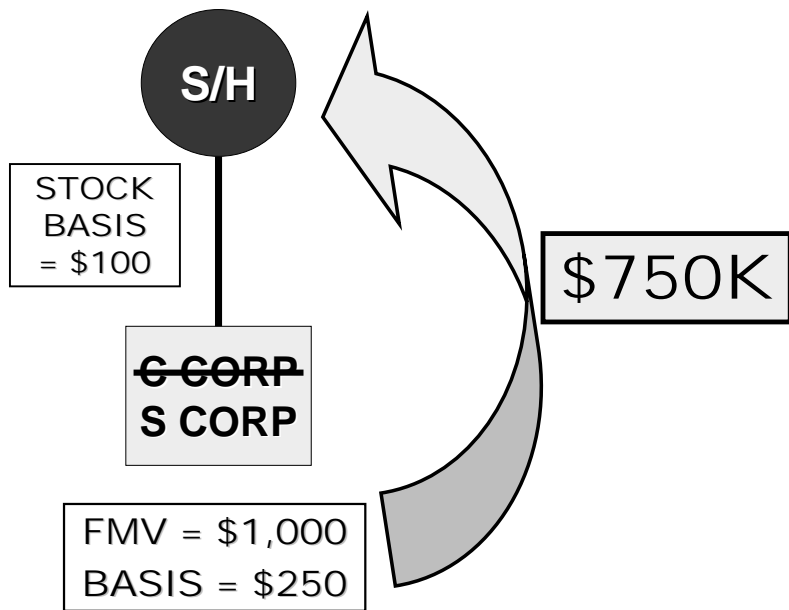
Sec. 1374

S CORP

BUILT-IN

GAINS TAX

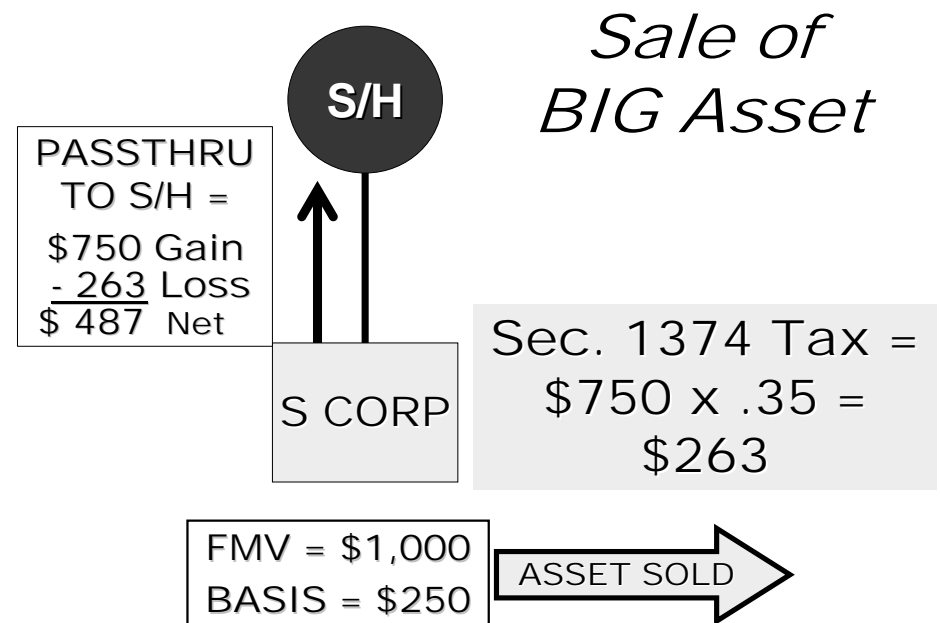




Built-In Gains Tax

**Can be tougher than
C corp taxation:**

Immediate
**double taxation
at the
highest tax rate**



**ARRA:
S Corp BIG Tax**

*Temporary Reduction
of
Recognition Period*

5-9

**ARRA:
2009 & 2010**

5-9

*No BIG Tax Owed
on Built-In Gains
Recognized
after Year 7 of
Recognition Period*

**CALIFORNIA
NON-CONFORMITY**

~~*No BIG Tax Owed
on Built-In Gains
Recognized
after Year 7 of
Recognition Period*~~

5-10

Installment Sales

*BIG Tax is Owed
on Installment Gains
Recognized
after 10-Year
Recognition Period*

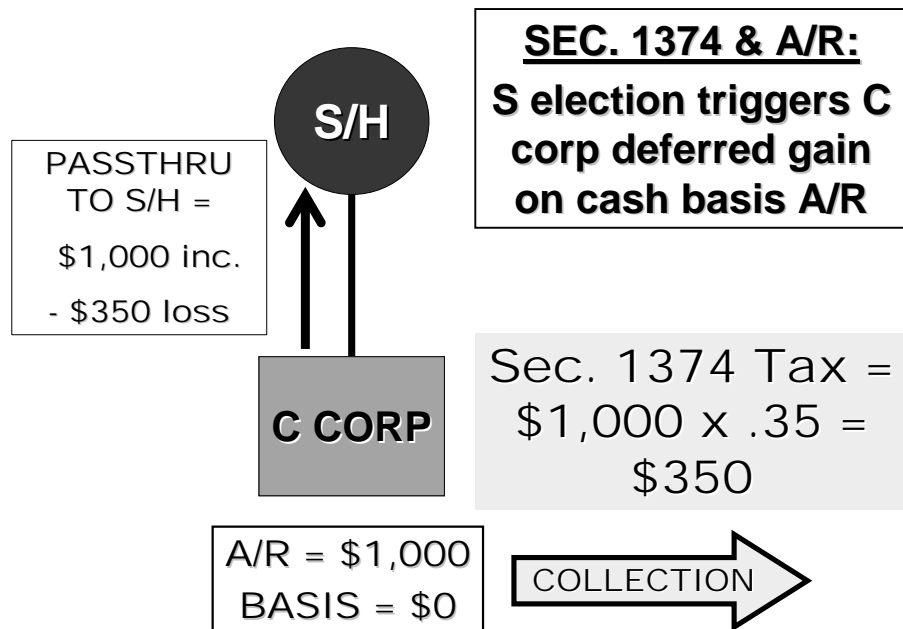
5-9

*Installment Sale
in Year 8:
Elect Out
of
Installment Treatment
to
Trigger BIG?*

5-9

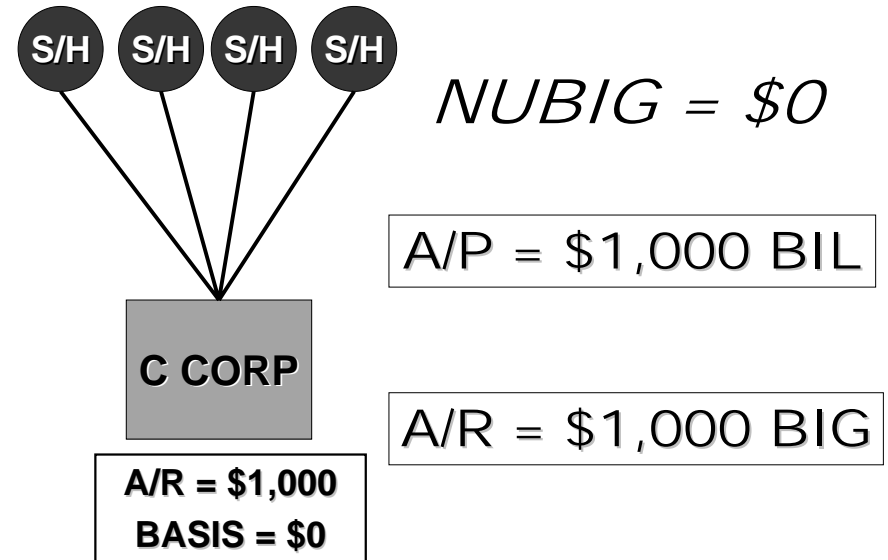
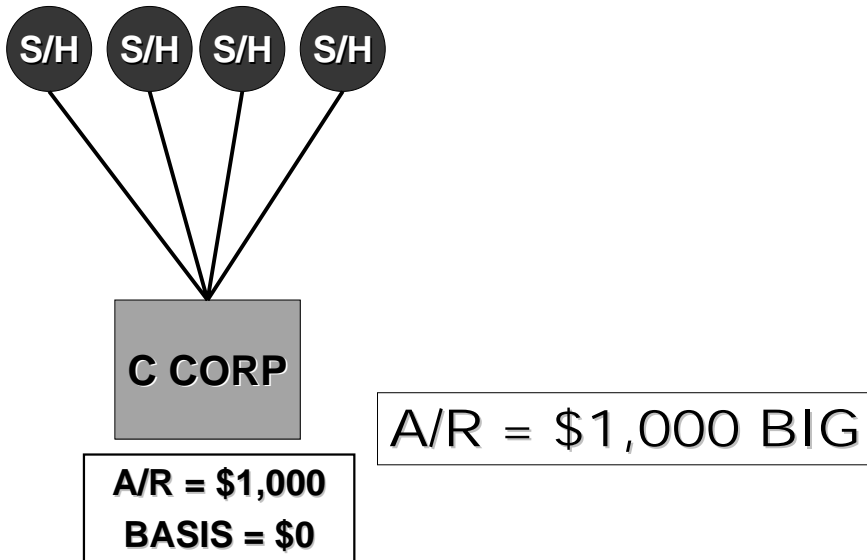
Accounts Receivable:

Big Problem
for
Electing
Cash Method
Corporations



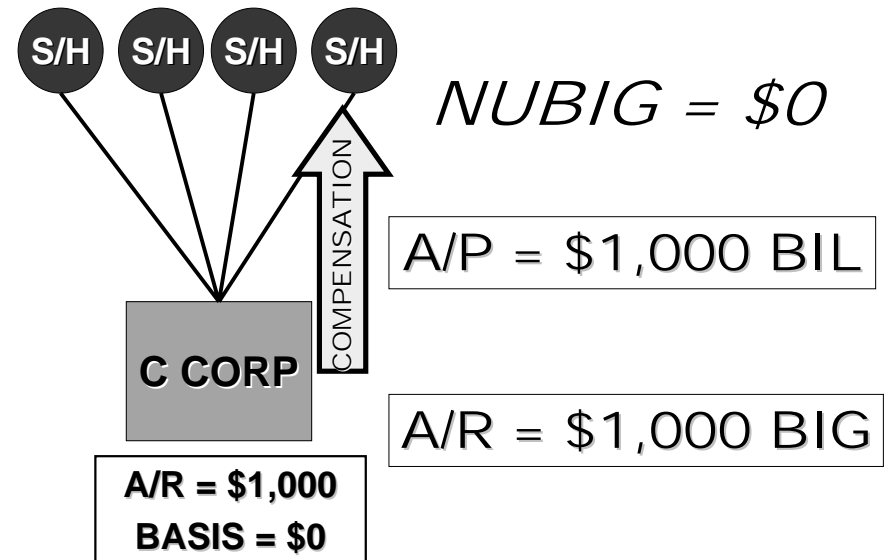
Avoiding BIG Tax on A/R

*Offsetting
Built-In Gains
with
Built-In-Losses*



PLR 200929005

Salary Payments as Built-in Losses

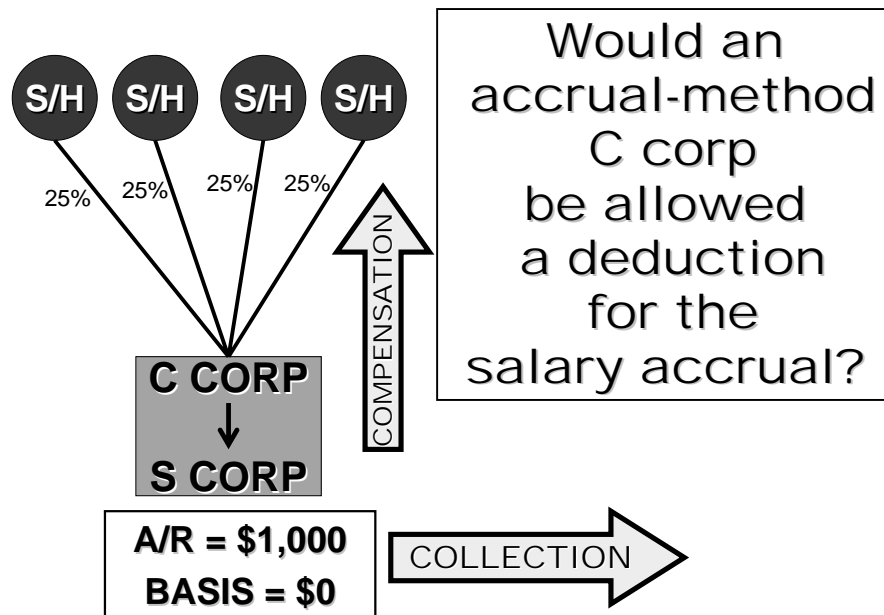


When can
accrued deductions
be taken into account
as built-in-losses
at the time of
the S election?

Reg. §1.1374-4(c)

Deduction is B-I-L:

“ . . .if the item would have been properly allowed as a deduction against gross income before the beginning of the recognition period to an accrual method taxpayer.”



Sec. 267(a)(2)

All shareholders of a personal service corporation (under sec. 441) are considered related parties:

No deduction for year-end salary accruals

Sec. 441:

PERSONAL SERVICE CORPORATION:

- (1) The principal activity is the performance of personal services;**
- (2) Those services are substantially performed (20%) by employee-owners;**
- (3) Employee-owners own more than 10% of the FMV of the stock.**

Reg. §1.1374-4(c)

Built-In Loss Treatment for Related Party Accruals:

- Liability must be *fixed and known* at start of first S year, and
- Must be paid in first *2½ months*, or
- Must be to *less than 5% owner*

Sec. 404(a)(5)

Year-end salary accruals that are part of a deferred compensation plan:

No deduction allowed until salaries paid.

Reg. §1.1374-4(c)(2)

Built-In Loss Treatment for Deferred Compensation:

- Liability must be fixed and known at start of first S year, and
- Must not be paid to a sec. 267(a)(2) related party

PLR 200925005

- *Salaries to owners*
- *Salaries to non-owners*
- *Associated P/R taxes*

Related to A/R

5-12

Other BIG Income/Deduction Items:

- Cancellation of Debt
- Bad Debt Expense
- Completed Contracts
- Sec. 481(a) Adjustments

MMC Corp v. Comm'r.

*Sec. 481(a)
Adjustments
as
Built-In Gains*

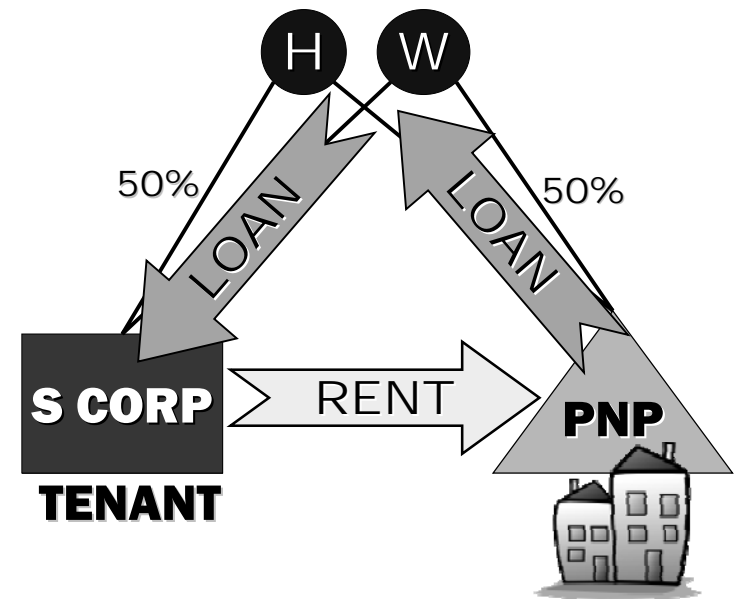
5-13

S Corp Shareholder Loans

Kerzner v. Comm'r.

*No
Shareholder Basis
for
Back-to-Back Loans*

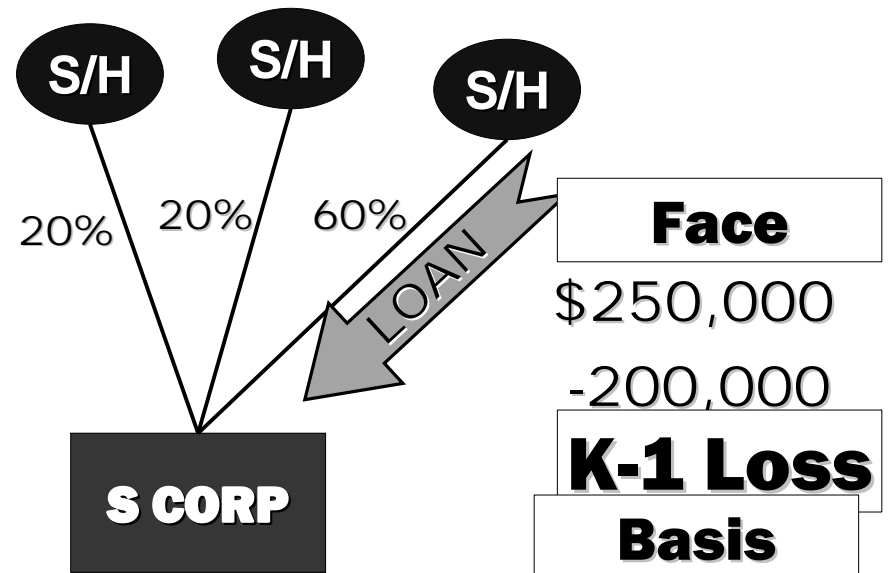
5-15

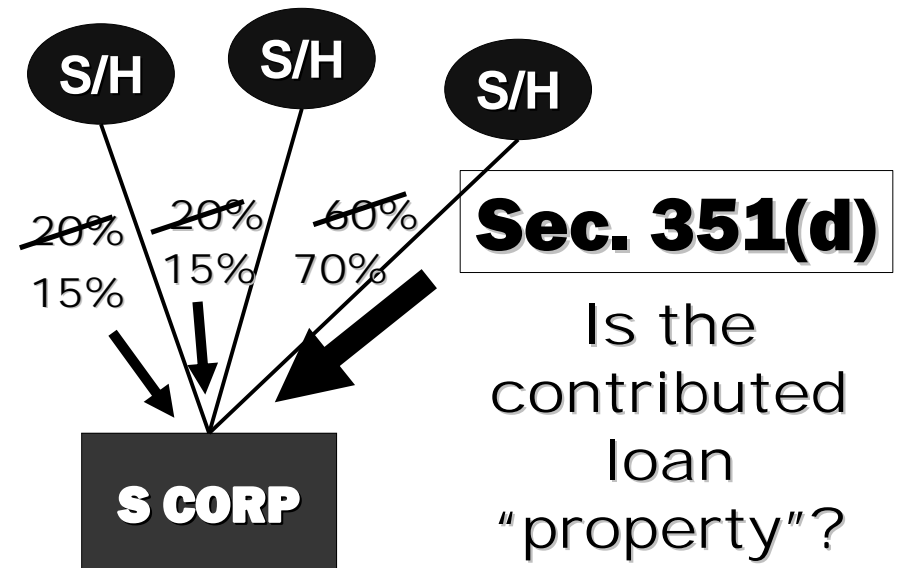
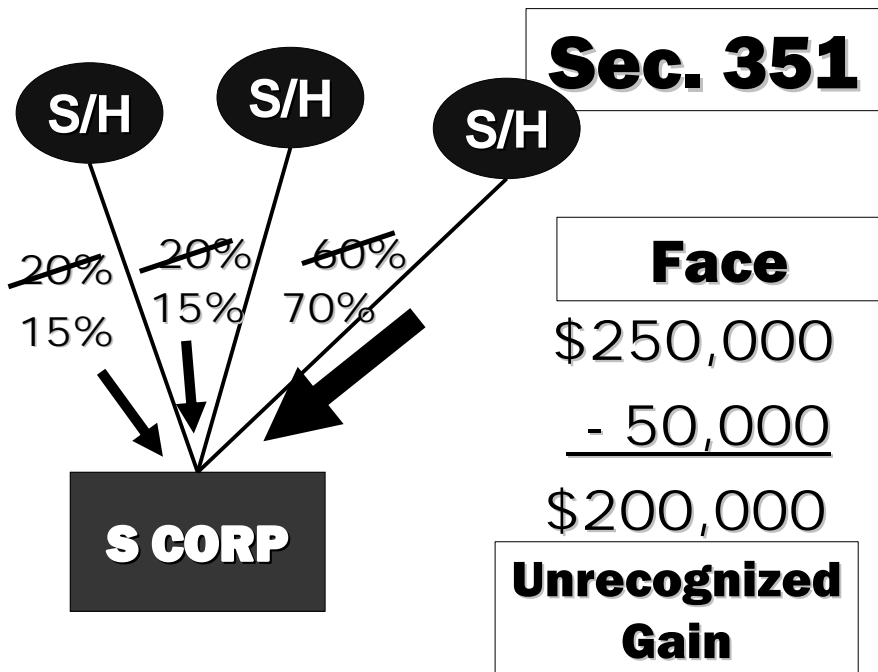
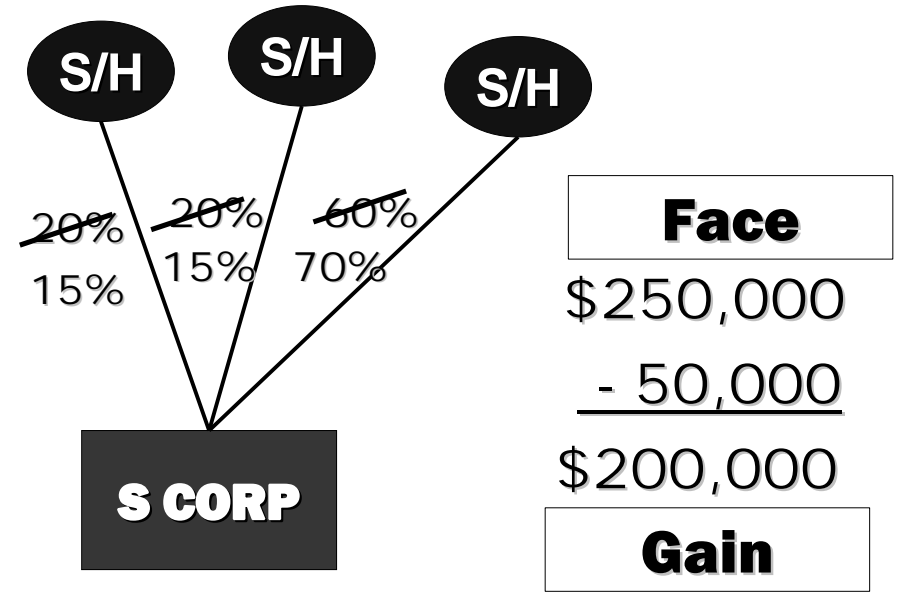
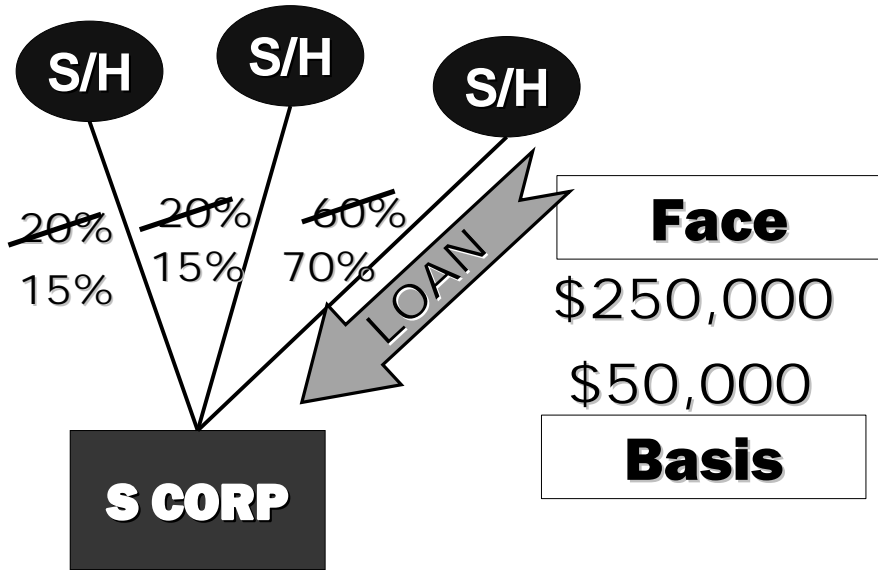


Russell v. Comm'r.

*Gain Recognition
on
Capital Contribution of
Shareholder Loan*

5-17

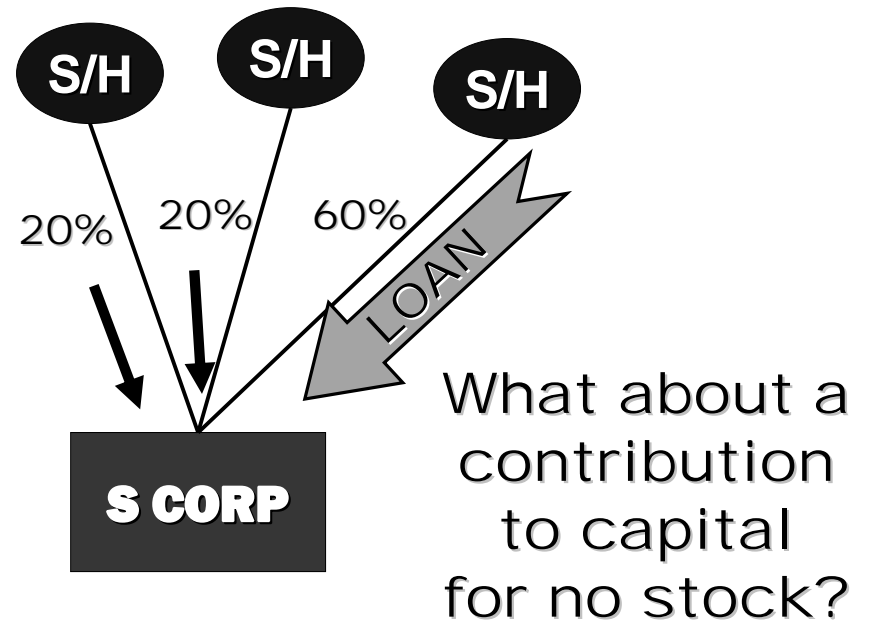




Sec. 351(d)(2)

Indebtedness of the transferee corporation which is not evidenced by a security . . .

5-17



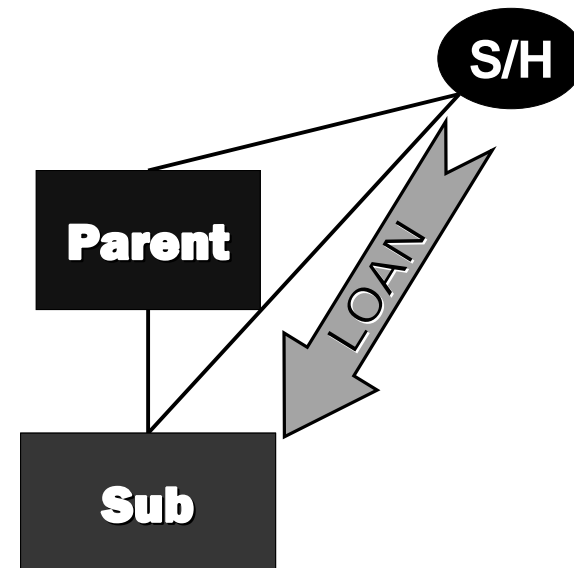
§118: Cap Contribs not Income

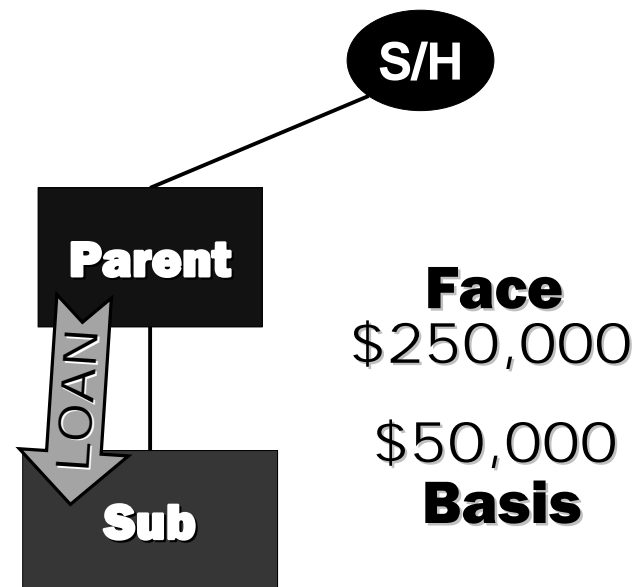
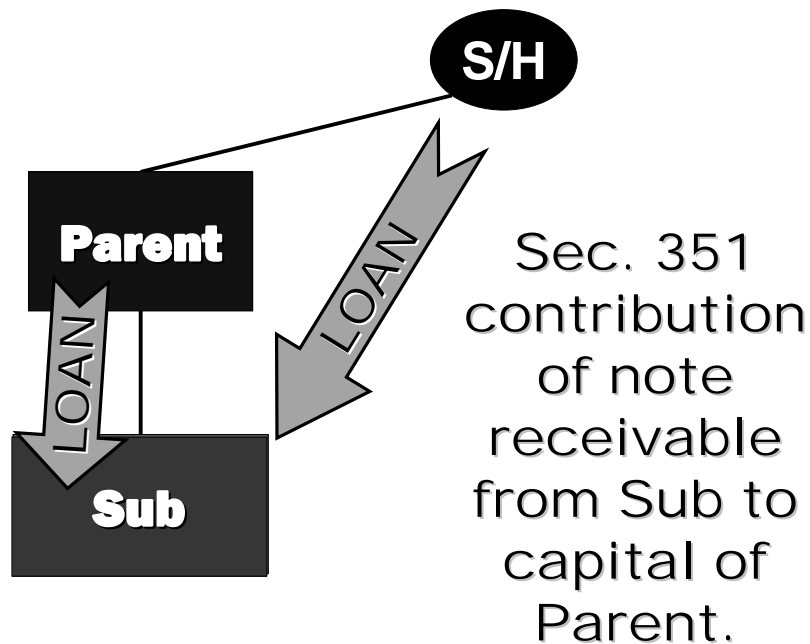
§108(e)(6): No 118 for Debt Contribs

- *Debt seemed satisfied for S/H's basis*

§108(d)(7)(c): S/H's loan basis determined w/o regard to S corp loss passthrough

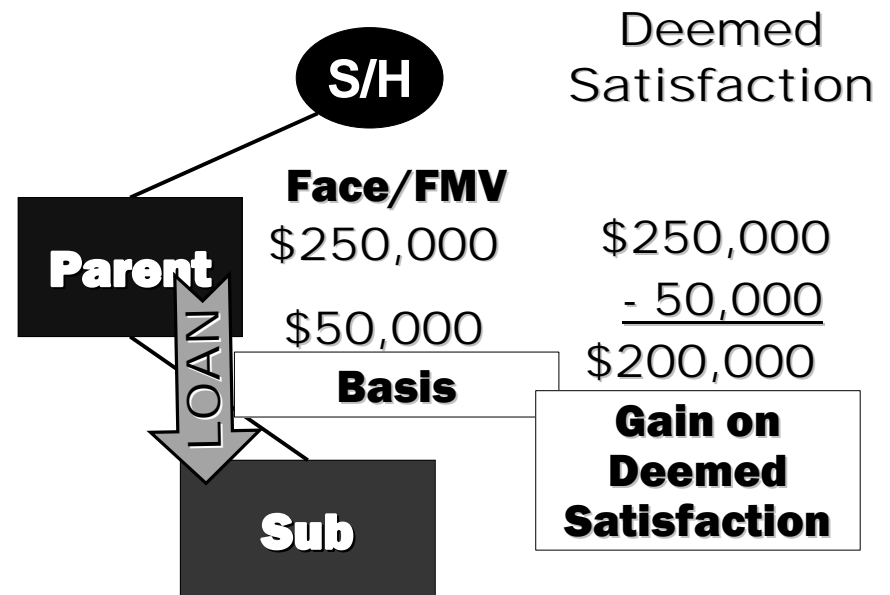
5-18

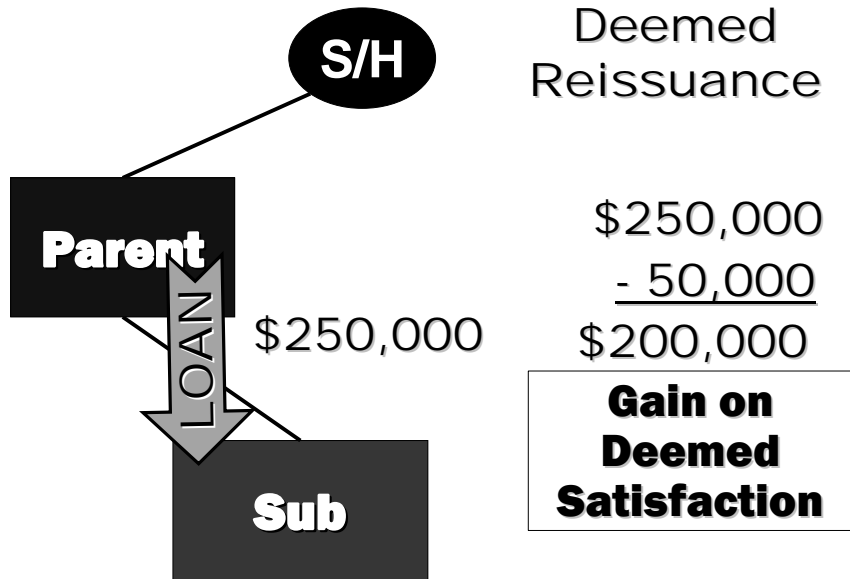




*Reg. §1.1502-13(g)(3)(i)(B)(1)
Intercompany Transfer?*

*Reg. §1.1502-13(g)(5)(ii)(B)
Deemed Satisfaction
& Reissuance?*





Reg. §1.108-7(d)

*S Corp
Attribute Reduction
Following
Cancellation of Debt*

5-19

Attribute Reduction

*C Corp
NOL Carryovers
to S Years
are not
Tax Attributes
that get
Reduced by COD*

5-19

Sec. 108(d)(7)(b)

*Suspended shareholder
S corp losses are
"deemed NOLs" subject
to attribute reduction.*

5-20

Sec. 108(d)(7)(b)

“Deemed NOLs” include only suspended deductible losses.

5-20

Reg. §1.108-7(d)

Reduction of S/H suspended losses is not proportional to stock ownership.

5-20

“Excess Deemed NOLs”

Determine suspended losses in excess of the COD income, and allocate this excess amount among the shareholders

5-20

5-21

| | <u>A</u> | <u>B</u> | <u>C</u> |
|-------------------------|-------------------|-------------------|-------------|
| 2009 Loss: | \$(10) | \$(10) | \$(10) |
| Prior Suspnd: | <u>-</u> | <u>(10)</u> | <u>(20)</u> |
| Total Susp'd: | \$(10) | \$(20) | \$(30) |
| COD Income: | <u>15</u> | <u>15</u> | <u>15</u> |
| Excess Susp'd: | - | \$(5) | \$(15) |
| Share of Excess Susp'd: | | 25% | 75% |
| COD Income = | \$45,000 | | |
| Deemed NOL = | <u>\$(60,000)</u> | | |
| | \$(15,000) | Excess Deemed NOL | |

5-21

| | <u>A</u> | <u>B</u> | <u>C</u> |
|-------------------------|-----------|-------------|-------------|
| 2009 Loss: | \$(10) | \$(10) | \$(10) |
| Prior Suspnd: | <u>-</u> | <u>(10)</u> | <u>(20)</u> |
| Total Susp'd: | \$(10) | \$(20) | \$(30) |
| COD Income: | <u>15</u> | <u>15</u> | <u>15</u> |
| Excess Susp'd: | - | \$(5) | \$(15) |
| Share of Excess Susp'd: | | 25% | 75% |
| Excess Deemed NOL: | | \$(3.75) | \$(11.25) |

Taproot Admin Services

*Roth IRA
Ineligible
S Corp Shareholder*

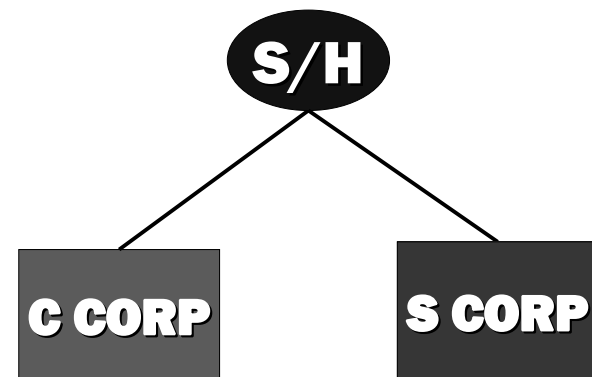
5-22

Reg. §1.1563

*S Corps
&
Controlled Group
Limitations*

5-23

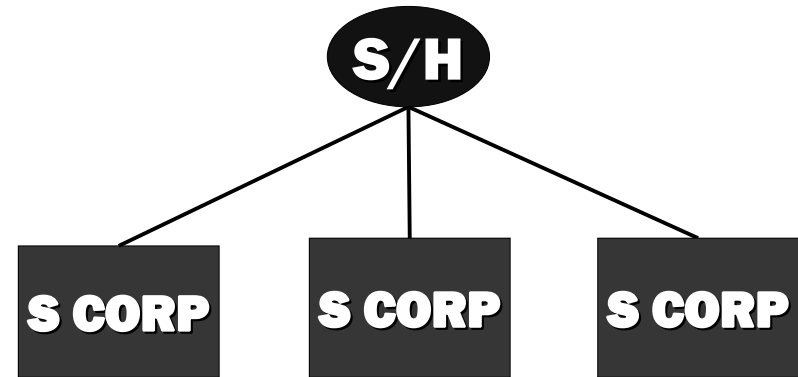
“Component Member” of a Controlled Group



S Corp is an “excluded member” of a controlled group only for purposes of any tax benefit described in §1561(a) to which it is not subject.

5-24

“Controlled Group”



Rev. Proc. 2009-41

*Relief for
Late
Entity Classification
Elections*

5-25

“CHECK-THE BOX” FORM

| | | |
|---|--|--------------------------------|
| Form 8832 (Rev. March 2007) Department of the Treasury Internal Revenue Service | Entity Classification Election | OMB No. 1545-1516 |
| Name of eligible entity making election | | Employer identification number |
| Type or Print | Number, street, and room or suite no. If a P.O. box, see instructions. | |
| | City or town, state, and ZIP code. If a foreign address, enter city, province or state, postal code and country. Follow the country's practice for entering the postal code. | |
| ▶ Check if: <input type="checkbox"/> Address change | | |

75 days

1 Type of election (see instructions):

- a Initial classification by a newly-formed entity. Skip lines 2a and 2b and go to line 3.
- b Change in current classification. Go to line 2a.

2a Has the eligible entity previously filed an entity election that had an effective date within the last 60 months?

- Yes.** Go to line 2b.
- No.** Skip line 2b and go to line 3.

2b Was the eligible entity's prior election for initial classification by a newly formed entity effective on the date of formation?

- Yes.** Go to line 3.

Rev Proc 2009-41

| | | |
|---|--|--------------------------------|
| Form 8832 (Rev. March 2007) Department of the Treasury Internal Revenue Service | Entity Classification Election | OMB No. 1545-1516 |
| Type or Print | Name of eligible entity making election | Employer identification number |
| | Number, street, and room or suite no. If a P.O. box, see instructions. | |
| | City or town, state, and ZIP code. If a foreign address, enter city, province or state, postal code and country. Follow the country's practice for entering the postal code. | |
| | ▶ Check if: <input type="checkbox"/> Address change | |

3 yrs & 75 days

1 Type of election (see instructions):

- a Initial classification by a newly-formed entity. Skip lines 2a and 2b and go to line 3.
- b Change in current classification. Go to line 2a.

2a Has the eligible entity previously filed an entity election that had an effective date within the last 60 months?

- Yes.** Go to line 2b.
- No.** Skip line 2b and go to line 3.

2b Was the eligible entity's prior election for initial classification by a newly formed entity effective on the date of formation?

- Yes.** Go to line 3.

Rev. Rul. 2009-15

Partnership to S Corp Conversions

5-27