

S Corporation Update

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Late Elections

- PLRs continue
- Almost anyone can get one
- Common Thread
 - Reasonable excuse and diligence when discovered

Late Election cont.

- Not everyone will qualify
- Missed election
- 5 years elapsed
- Kids now own and want it corrected
- Called IRS before PLR

Late Election cont.

- Per IRS
- Would most likely deny
- Taxpayer knew for 5 years
- Didn't act timely
- Even though had been reporting as if had been made

Business Purpose

- Section 355 Business purpose had been met for Spin-off of Qsubs (PLR 200422020)
- Managers would leave if didn't get stock ownership

Business Purpose cont.

- Business purpose has been fairly hard to justify under 355.
- This case allows business purpose to also be a benefit to shareholders of S Corp parent

S Election Spouse Signature

- Rev Rule 2004-35
- Automatic relief for failure to file valid S election when spouse in community property state fails to sign 2553

Spouse Signature cont.

- Community property states only
- Must have reported all the income on their return for the relief to apply

Classification Election

- Reg 301.7701-3T(c)(1)(v)(C)
- Failure to file form 8832
classification election
- But did file 2553 (S election)
- Will be deemed to have filed 8832

Related Relief

- Rev Proc 2004-48
- If didn't file 2553 and also
didn't file 8832
- Simplified method for
requesting relief instead of PLR

Rev Proc 2004-48 cont.

- Must file within 6 months of due date (including extensions)
- Include form 2553
- “Filed under Rev Proc 2004-48”
- Statement of reasonable cause

Indian Tribe Ineligible

- Rev Rule 2004-50
- Indian Tribe is not “individual” under 1361(b)(1)(B)
- Also not exempt organization for exceptions in 1362

Passive Income

- Passive income from rents clarified
- PLR 200422019
- Active trade or business of renting property is not passive income for 1362(d)(3)(C)(i)

Passive Income cont.

- Don't confuse passive activity limitation – passive income with
- Section 1362 passive income that will blow S election if have accumulated E&P

Active Trade or Business

- Examples
 - Management duties
 - Pay taxes
 - Pay insurance
 - May use agents to fulfill some duties

Bankruptcy

- Bankruptcy estate gets full year losses – Individual gets zip
- William filed bankruptcy December 3
- Tried to take 11/12ths of the loss (of over \$3 Million)

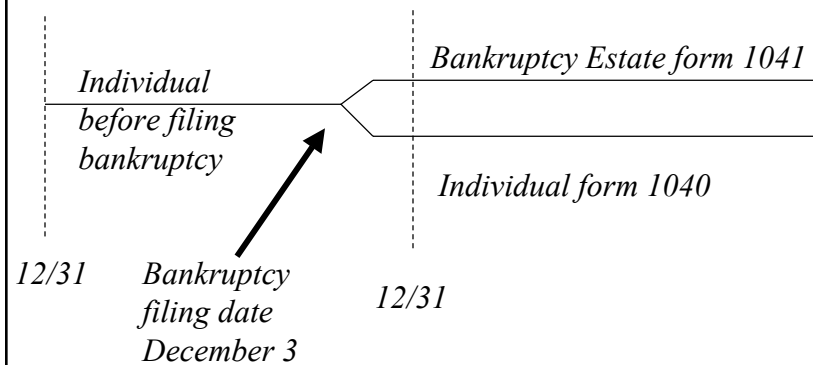
Bankruptcy cont.

- Taxpayer claimed filing bankruptcy was taxable change in shareholders
- Tax Court disagreed
- Section 1398 (no taxable event upon filing bankruptcy) controls

Bankruptcy cont.

- Two other ways to skin the cat
 - Termination of S election by selling one share of stock to ineligible shareholder
 - Sell all your stock for FMV before filing bankruptcy

How It Works



Caution if S Corp Files

- Consider terminating S election before the S Corporation files bankruptcy
- If not, shareholders may get income with no cash as assets sold by bankruptcy trustee

Reasonable Comp.

- S Corp sole shareholder, sole employee, no salary
- Should have learned lesson by now.

Reasonable Comp. cont.

- Magic unofficial number seems to be somewhere in the mid \$30,000's
- Attach explanation to return if shareholder doesn't work for entity
- "Officers Comp" not Shareholders Comp

Basis Blowout

- Ellinger tried to get basis under Gitlitz forgiveness of income rule before it was closed
- Court said no valid debt involved so no basis increase

Basis cont.

- Taxpayer also didn't get basis for inter-company loans reclassified as distribution to shareholder and contribution to capital
- Probably a common issue

Loan Repayment with Partial Basis

- Per old Smith and Novell cases, loan repayments with partial basis create gain
- Multiply repayment by fraction to determine income

Loan Repayment cont.

$$\frac{\text{Face} - \text{Remaining Basis}}{\text{Face of note}} * \text{payment}$$

= income to report

Repayment cont.

- If promissory note – income is capital gain
- If no promissory note – income is ordinary

Repayment cont.

- Our software does it incorrectly
- Does yours?

Put Land in an S Corp?

- Yes
 - When it will be developed and become inventory
 - Pay owner reasonable compensation
 - Remainder escapes SE tax

Land cont.

- If taxpayer already owns land as investment, consider having him sell it to the development corporation on the installment basis and capture some gain as LTCG

Liquidation of Inherited S Corp

- Oldie but Goodie
- Received step up in stock basis only
- Liquidate corporation in same year as sell assets.
- Help offset some gains with LTCL

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