Hot Tax Planning Tips and Strategies – S Corporations

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This presentation should be viewed only as a summary of the law and not as a substitute for tax or legal consultation in a particular case. Your comments and questions are always welcome.

S corps - 1

Situation: S corp is subject to excess passive receipts penalty tax. (Or maybe it's a personal holding company that wishes it could be an S corp.)

Issue: How to pump up active receipts to over 75% of all receipts to beat the excess passive recipts penalties (penalty tax and loss of S status)?

S corps -1

Beating the Passive Receipts Penalties

- The S corp buys interests in publicly-traded gas distribution LPs or LLCs.
  - The active receipts flow through to the S corp and retain their active character for purposes of the excess passive receipts rules.
  - The LP/LLCs' margins are thin, so a dollar buys a little bit of earnings but a lot of active receipts.

S corps - 2

Situation: Sole shareholder of S corp dies. Heir wants to keep asset. The S corp's asset would create LT capital gain when sold. S corp has zero basis in asset.

Tip: Distribute the asset. There will be no income tax on the distribution.

S corps - 2

Zero tax distribution of S corp asset

- Heir gets a basis step-up in stock to FMV – to $100.
- S corp distributes asset.
  - Gain of $100 flows through to heir.
  - Heir's stock basis jumps from $100 to $200.
- Heir receives asset in liquidation of S corp.
  - Amount realized on distribution = $100 = FMV
  - Basis in stock = $200
  - $100 *outside* capital *loss* on distribution offsets $100 *inside* capital *gain* on distribution.

S corps - 2

Situation: Sole shareholder of S corp dies. Heir wants to *sell* asset. The S corp's asset would create LT capital gain when sold. S corp has zero basis in asset.

Tip: Sell the asset *and distribute the proceeds in the same year*. There will be no income tax on the sale or distribution.

S corps - 3

Zero tax *sale* of S corp asset

- Heir gets a basis step-up in stock to FMV – to $100.
- S corp sells asset.
  - Gain of $100 flows through to heir.
  - Heir's stock basis jumps from $100 to $200.
- *Same year:* Heir receives cash in liquidation of S corp.
  - Amount realized on distribution = $100 = FMV
  - Basis in stock = $200
  - $100 *outside* capital *loss* on *distribution* offsets $100 inside capital *gain* on *sale*.

S corps - 4

Botched zero tax *sale* of S corp asset

- Heir gets a basis step-up in stock to FMV – to $100.
- S corp sells asset.
  - Gain of $100 flows through to heir.
  - Heir pays tax on capital gain.
  - Heir's stock basis jumps from $100 to $200.
- *Next* year: Heir receives cash in liquidation of S corp.
  - Amount realized on distribution = $100 = FMV
  - Basis in stock = $200
  - $100 *outside* capital *loss* on *distribution.*
  - No offset or carry back!

S corps - 5

Situation: S corp issues new shares – or S corp shareholder sells shares.

Problem:

- Get the *old* shareholders enough cash to pay their tax on their S corp income -- without over-paying the *new* shareholder.
- Must distribute the same number of dollars per share to all shareholders under corporate law -- and to avoid a one-class-of-stock problem.

S corps - 5

Share transfers and distributions to pay tax

Tip: Make a distribution to clean out the undistributed S corp profit *before* the stock transaction. Maybe loan it back, if needed.

Or take solace in the high stock basis of the old shareholders.

- *Immediate* benefit to the shareholder who sold stock.
- *Deferred* benefit when the corp issues new shares.

S corps - 6

Situation: C corp (OldCo) wants to make a mid-year S corp election.

Tip:

1. Organize a new corp, make the S corp election for NewCo.
2. Contribute OldCo stock to NewCo and make a QSub election for OldCo.
3. Establish a business purpose for NewCo, maybe by creating another subsidiary.

S corps - 7

Situation: Parent is reluctant to continue giving children S corp stock now that Parent is approaching 50% ownership. Parent wants to retain control.

Tip:

1. Convert each outstanding share to one voting and nine non-voting shares.
2. Parent continues giving non-voting shares.
3. Parent retains control with voting shares.

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