



S CORPORATIONS

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Wipfli Tax Update 2021

- Topics to be covered:
 - ▶ LLC as an S corporation
 - ▶ Shareholder basis reporting update
 - ▶ Ownership changes & allocations for that year
 - ▶ Estates and Trusts as S corporation shareholders
 - ▶ F Reorganizations

LLC as an S Corporation

- Ensure Operating Agreement is reviewed for S corporation violations
 - ▶ Only one class of stock
 - ▶ References to partnership allocation provisions removed
 - ▶ Ensuring only eligible S corporation shareholders as members of LLC
- Blown S election reverts the entity to a C corporation
 - ▶ Does not restore it back to partnership
 - ▶ Could have a 5-year waiting period before converting back to S corporation
 - ▶ Expensive PLR requests could be avoided by being proactive
- From 2553 – S election
 - ▶ Serves as both check the box election & S election
 - ▶ Form 8832 is not needed as well (See Form 2553 Instructions which calls this out)
 - ▶ LLC can be converted mid-year to S corporation if not previously a corporate entity

S Corporation – Shareholder Basis Reporting

- Required at shareholder level to support losses and distributions
- IRS draft Form 7203
 - ▶ Comments on draft form submitted by Rich Salter in September
 - ▶ Draft form tracks both stock basis and debt basis
 - ▶ Debt basis is tracked by loan in the draft & checkboxes indicate whether it is a “formal note” or “open account debt”
 - ▶ Stay tuned for finalized versions of this form
- Direct shareholder loans to the corporation provide basis for losses
 - ▶ Make sure loans are properly documented (not just book entries at year-end)
 - ▶ Ensure direct loans by shareholder & NOT from related entities
 - ▶ Be careful when loans are repaid before debt basis is restored
 - ▶ Personal guarantees on business debt don't provide debt basis for losses in an S corporation

S Corporation – Ownership Change Allocations

- Default treatment: Per share, per day allocation
- Sec. 1377(a)(1) election
 - ▶ For complete dispositions
 - ▶ Split the tax year into segments for allocations purposes
 - ▶ All affected shareholders must consent to election (know this in advance)
- Reg 1.1368-1(g)(2) election
 - ▶ Only for qualifying transactions
 - Shareholder disposes of 20% or more of issued stock within 30-day period in tax year
 - 20% or more outstanding stock redeemed from a shareholder within 30-day period in tax year
 - Stock of 25% or greater than previously outstanding shares is issued to one or more new shareholders within 30-days during tax year

Estates & Trusts as S Corporation Shareholders

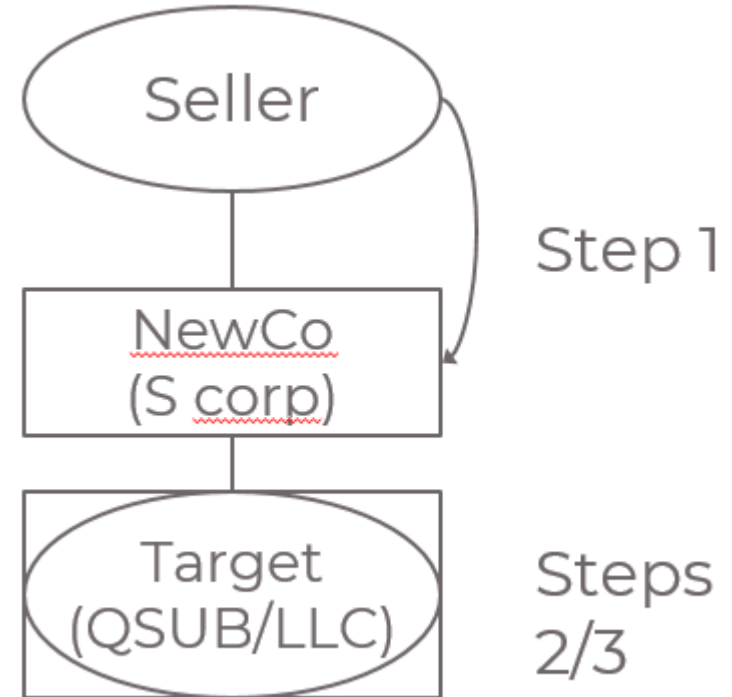
- Permitted non-individual shareholders:
 - ▶ Estates (limited to administrative period)
 - ▶ Testamentary trusts (generally limited to two-years)
 - ▶ Voting trusts
 - ▶ Grantor trusts (generally limited to two-years after death)
 - ▶ Qualified subchapter S trusts, a/k/a QSST (valid election required)
 - ▶ Electing small business trusts, a/k/a ESBT (valid election required)
 - ▶ Tax exempt qualified retirement plan trusts under Sec. 401(a)
 - Like an ESOP
 - Not a SEP, SIMPLE IRA or ROTH IRA; those aren't under Sec. 401(a)

S Corporation – “F” Reorganizations (Rev. Rul. 2008-18)

- Becoming more common in acquisitions of an S corporation
 - ▶ Requires actions in advance of closing & ordering of steps is critical
 - ▶ Can relieve buyer concern on valid seller S election & maintenance of the election
 - ▶ Taxed as asset sale without needing a Sec. 338(h)(10) election
 - ▶ May allow for some tax-free rollover that a Sec. 338(h)(10) would not
 - ▶ Can allow for buyer to take on the entity’s FEIN where that is critical while still allowing asset acquisition treatment that buyer wants

S Corporation – “F” Reorganizations (RR 2008-18)

- Seller forms NewCo and contributes 100% of Target to NewCo.
- NewCo files QSUB election, Form 8869, on behalf of Target (together with Step 1, the “F” reorganization under Rev. Rul. 2008-18). As a result, NewCo inherits Target’s historic S election and other tax attributes.
- Target converts to LLC under state law or elects to be classified as a disregarded entity if already an LLC.



S Corporation – “F” Reorganizations (RR 2008-18)

- Purchaser can acquire 100% of Target LLC or any lower amount vs Sec. 338(h)(10) election requires at least 80% acquisition for qualified stock purchase
- Allows for greater than 20% tax-free rollover - seller must hold their rollover equity through the NewCo S corporation in order to preserve tax-free roll
- Eliminates buyer risk on S election
- **Trap for the unwary
 - ▶ Pursuant to Reg. 1.1361-3(a)(1), the Form 8869/QSUB election must be filed prior to any LLC conversion or entity classification election (regardless of effective date for such QSUB election)
 - ▶ Failure to file the form prior to such conversion will invalidate the “F” reorganization (see PLR 201724013)