

2023
National
Income Tax
Workbook

Chapter 11: Business entity tax issues
PP. 379-426



Learning Objectives

- Understand the tax consequences of a partnership interest sale
- Know how redemption of a partnership interest is taxed
- Calculate S corporation stock & loan basis
- Know when an S corporation shareholder must file Form 7203
- Calculate the gain on repayment of an S corporation shareholder loan that has a reduced basis
- Understand how to complete Form 7203
- Know the eligibility requirements of I.R.C. §501(c)(6) business leagues
- Understand the tax filing obligations for §501(c)(6) organization
- Recognize when Schedules K-2 and K-3 are required



Issue 1: Partnership Interest Sale vs. Redemption

Liquidating a Partnership

P. 381

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graph TD; A[Purchase of interest] --> B[Redemption of interest]; B --> C[Received in cash]; C --> D[Received in property]; D --> E[Multimember LLC];
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Purchase of interest

Redemption of interest

Received in cash

Received in property

Multimember LLC



Sale of Partnership Interest

P. 381

I.R.C. §741 general rule

Sale as a capital asset

Capital gain/loss to selling partner

Gain/loss = amount realized – partners outside basis

Partnership liabilities = cash contribution = increase outside basis



Sale of Partnership Interest

P. 381

I.R.C. §741 general rule EXCEPTION


Ordinary income assets

Look-through concept

Characterizes part of gain/loss on sale to ordinary gain/loss

Unrecaptured §1250 gain or collectibles gain

Practitioner Note – Related Party Sales



§751(a)
Assets
P. 381

Prevent conversion of ordinary income to capital gain

Prevents shifting income among partners

Ordinary gain/loss

Selling partners unrealized receivables & inventory items

§ 1245 & § 1250 depreciation recapture

Substantially appreciated items

Disproportionate distributions

§751 (a) Assets – Unrealized Receivables

751 (c) – right to payment
for goods or services

Ordinary income at FMV

Recapture § 1245 &
§ 1250

§751 (a) Assets – Inventory (“hot assets”)

§751 (d) – I.R.C. 1221 (a)(1)

Not a capital asset

Not §1231 property

Deemed Sale – ordinary gain/loss

- Gain/loss from §751 (a) property
- Allocated to selling partner
- FMV if partnership sold
- Capital gain -- remainder

Example 11.1 –
Partnership
Interest Sale No
Hot Assets



Continental Divide – 3 equal partners

Renee -- \$50,000 outside basis & no liabilities

Renee sells interest for \$100,000

No hot assets

\$50,000 capital gain

Example 11.1 – Partnership Interest Sale No Hot Assets

Continental Divide – 3 equal partners

Renee -- \$50,000 outside basis & no liabilities

Renee sells interest for \$100,000

\$30,000 inventory basis & \$45,000 FMV

\$5,000 ordinary income

\$45,000 capital gain

Look-Through Gains

Held more than 1 year

Unrecaptured § 1250 gain

25% max tax rate

28% max tax rate on collectibles

Example 11.2 Unrecaptured §1250 Gain

- Two Rivers – 20% Alex, 40% Bella, & 40% Chad
- Bella sells to Chad for \$400,000
- FMV of partnership is \$1,000,000
- No §751 (a) gain or liabilities
- Bella -- \$320,000 outside basis
- \$80,000 gain on sale of her interest

Example 11.2 Unrecaptured §1250 Gain

- Partnership building basis = \$1,480,000
- FMV = \$1,670,000
- §1250 gain = depreciation taken, limited to actual gain on sale
- \$190,000 gain on sale of building
- Limited §1250 gain = \$80,000
- Bella -- \$32,000 §1250 gain
 - Taxed at 25%
 - \$48,000 capital gain

Installment Sale

- Purchase paid over more than one tax year
- Gain/loss on payments made
- Seller can elect out
- Not available:
 - Inventory
 - Receivables
 - Recapture
 - Report in year of sale NOT over time
- Cross-Reference – Basis Adjustment Election

► Beginning in 2021, S Corp. Shareholders may have to file _____ to report their basis:

► Form 7203

► Form 1099

► Form 1040-ES


Polling Question # 1

Redemption of a Partnership Interest

- §736(b) – general rule for distributions
- §751(b) – hot assets = ordinary gain/loss
- §736(a) – Service General Partners
 - Capital gain/loss
 - Cash received >/< partner's basis or partnership interest
 - Cash distributions
 - Reduce capital account
 - Reduce basis of recipient
 - Distributions > adjusted basis = taxable event (§731)
- Practitioner Note – Liability Relief

751 (b) Assets

- Unrealized receivables
- Substantially appreciated inventory items
- Ordinary income
- Distribution = sales or exchange
 - Receives a distribution of unrealized receivables or substantially appreciated inventory
 - Receives a distribution of partnership property in exchange for all or part of the partner's interest in the partnership's unrealized receivables or substantially appreciated inventory



751 (b) Assets

- Substantially appreciated inventory
- FMV of all inventory $>$ 120% of partnership's aggregated adjusted basis in inventory; AND
- FMV of inventory $>$ 10% of AMV of all partnership property except money

Example 11.3 – Disproportionate Distribution of Hot Assets

Ginger Restaurant Group – 3 equal partners	\$150,000 outside basis per partner	\$200,000 liquidating distribution to Anne
\$30,000 outside basis in hot assets	\$50,000 FMV hot assets	\$50,000 deemed distribution of hot assets
Basis reduction to \$120,000	\$20,000 ordinary gain on deemed sale	\$30,000 capital gain

Example 11.3 – Disproportionate Distribution of Hot Assets

ASSET	BASIS	FMV
Cash	\$300,000	\$300,000
Inventory(substantially appreciated)	90,000	150,000
Capital assets	<u>60,000</u>	<u>150,000</u>
Total assets	<u>\$450,000</u>	<u>\$600,000</u>

I.R.C. §736(a) Payments

Paid to general partners – service partnerships

Unrealized receivables

Goodwill treated as distributive share of partnership interest

I.R.C. §736(a) Payments

§702 income

Subject to SE tax

Guaranteed payment – redemption amount not based on partnerships income

Practitioner Note – Redemption of Goodwill

Practitioner Note – Conflict of Interest

FIGURE 11.2 Section 736(b) Redemption and Section 741 Sale Comparison

	736(b) Redemption	741 Sale
General tax consequences to seller	Capital gain or loss; ordinary for section 751 assets	Capital gain or loss; ordinary for section 751 assets
Subject to SE tax	No	No
Inventory taxed as ordinary income	Substantially appreciated inventory	All inventory
Recognition of ordinary income from hot assets	Ratable distribution*	In year of sale, even if treated as an installment sale
Unrecaptured 1250 gain	No tax on share of section unrecaptured 1250 gain	Maximum 25% tax rate applies to unrecaptured 1250 gain
Basis recovery (nonhot assets)	Recover full basis before recognizing gain	Pro rata basis recovery under installment sale
General tax consequences to partnership/buyer	Generally, delayed step-up as retiring partner recognizes gain, unless section 751 deemed sale or retiring partner elects to recover basis ratably	Cost basis in purchased interest—year 1
Imputed interest rules apply	No	Yes
Payments deductible by payer	No, [unless 736(a) guaranteed payment], but reduces distributable income	No
Liability relief included in income	Potentially deferred	Included in year of sale

* Section §736(b) payments are first allocable to the deemed section 751 exchange. Thus, when a partnership makes liquidating distributions in installments, under the general distribution rules, the retiring partner has ordinary income on each distribution that is a disproportionate distribution of hot assets. If the payments are fixed, some commenters suggest that the deemed section 751(b) exchange takes place at the onset of the payments, resulting in recognition of all the ordinary income from hot assets in the first year.

Issue 2: S Corporation Shareholder Basis

Stock Basis P. 387

- Shareholder's acquisition basis
- Adjusted each year by share of corporation's
 - Income
 - Deductions, losses
 - Distributions to shareholder

Acquisition Basis P. 387

- §351 tax-free stock
- Basis in property contributed
- Initial basis = cost of stock

Acquisition Basis P. 387

- Received from decedent
 - Basis = FMV of date of death/alternate valuation date
 - Inherited basis = reduce stock basis by income in respect of decedent
- Gifted stock
 - Donor's basis
 - FMV if $<$ donor's basis at time of gift
- Compensation – basis is FMV
- Practitioner Note – Income in Respect of a Decedent

Adjusted Basis Ordering P. 388

- Income items
- Distributions
- Nondeductible, noncapital expenses
- Items of loss and deduction

Example 11.4 – Stock Basis Reduced by Loss & Distribution

Beta Corp –
single
shareholder

\$20,000
Beginning stock
basis

\$75,000 ordinary
income

\$50,000
distributions

NO
accumulated E
& P

Cross-Reference
– Electing
Ordering Rule

FIGURE 11.3 Order of Stock Basis Adjustments

Birdie's stock basis at beginning of 2023	\$20,000
Step 1: Add current-year income items	75,000
Step 2: Subtract 2023 distributions	<u>(50,000)</u>
Birdie's stock basis at end of 2023	<u>\$45,000</u>

Debt Basis

- Direct loan to S corporation
- Economic outlay
- NOT by guaranteeing a corporate loan
- Bona fide indebtedness – making a payment on behalf of corporation
- Cross-Reference – Debt Basis

Adjustments to Debt Basis

- Loss allocation exceeds stock basis
- Debt basis adjustments
 - In the year of the loss, after stock basis is reduced to zero, the shareholder reduces debt basis
 - In a subsequent year when the corporation reports income and the shareholder has net increase in basis, the shareholder restores debt basis before increasing stock basis

Example 11.5 – Loss Adjustment to Debt Basis

- Lewiston Inc – single shareholder
- \$60,000 stock basis
- \$50,000 debt basis
- Promissory Note on debt
- 2022 = \$100,000 ordinary loss
- 2023 = \$140,000 ordinary income

FIGURE 11.4 Adjustments to George's Stock and Debt Basis

Adjustments	Stock Basis	Debt Basis	Total Basis
2022 beginning basis	\$60,000	\$50,000	\$110,000
2022 loss	(60,000)	(40,000)	(100,000)
2022 ending basis	\$0	\$10,000	\$10,000
2023 income	100,000	40,000	140,000
2023 ending basis	<u>\$100,000</u>	<u>\$50,000</u>	<u>\$150,000</u>

Repayment of Shareholder Loans

- Corporation repays shareholder
- Debt basis – reduced by loan payment
- Taxable event – when shareholder loan basis reduced by prior losses
- Capital Gain – repayment of loan
 - Written debt instrument
- Ordinary Income – repayment of loan
 - NO written debt instrument
- Interest = Ordinary Income

Example 11.6 – Repayment of Debt

Facts are same as Example 11.5

2023 – repaid \$25,000 of loan

\$10,000 debt basis

Long-term capital gain = \$20,000

- \$25,000 repayment – (10,000 debt basis X 50%)

Practitioner Note – Timing of Adjustments



Open Account Debt

- Treas. Reg. 1.1367-2
- Shareholder advances that are not evidenced by separate written instruments and repayments on advances
- The aggregate outstanding principal of which does not exceed \$25,000 at the end of the S corporation's tax year
- Year-end balance > \$25,000 classified as formal note

► A shareholder's _____ basis is their starting basis:

► Preferred

► Ending

► Acquisition

Polling Question # 2

Examples



Example 11.7 – Carry Over of Open Account Debt



Example 11.8 – Netting Repayment and Advance on Open Account Debt



Example 11.9 – Shareholder Indebtedness Exceeds \$25,000



Practitioner Note – Multiple Loans

Reporting S Corporation Basis

LB&I Division – compliance campaign

Form 7203 Filing Requirements

- Deduction for a share of an aggregated loss from S corporation
- A nondividend distribution from the S corporation
- A disposition of stock in an S corporation
- A loan repayment from an S corporation

Practitioner Note – Dividend Distributions

Schedule E – Form 1040

FIGURE 11.5 Schedule E (Form 1040) Basis Reporting

Schedule E (Form 1040) 2022 Attachment Sequence No. **13** Page **2**

Name(s) shown on return. Do not enter name and social security number if shown on other side. Your social security number

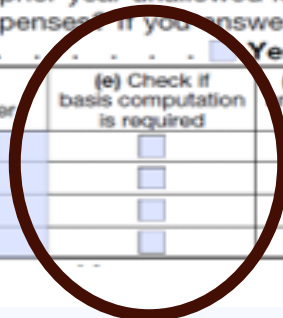
Caution: The IRS compares amounts reported on your tax return with amounts shown on Schedule(s) K-1.

Part II **Income or Loss From Partnerships and S Corporations**

Note: If you report a loss, receive a distribution, dispose of stock, or receive a loan repayment from an S corporation, you **must** check the box in column **(e)** on line 28 and attach the required basis computation. If you report a loss from an at-risk activity for which **any** amount is **not** at risk, you **must** check the box in column **(f)** on line 28 and attach **Form 6198**. See instructions.

27 Are you reporting any loss not allowed in a prior year due to the at-risk or basis limitations, a prior year unallowed loss from a passive activity (if that loss was not reported on Form 8582), or unreimbursed partnership expenses? If you answered "Yes," see instructions before completing this section Yes No

28	(a) Name	(b) Enter P for partnership; S for S corporation	(c) Check if foreign partnership	(d) Employer identification number	(e) Check if basis computation is required	(f) Check if any amount is not at risk
A			<input type="checkbox"/>		<input type="checkbox"/>	<input type="checkbox"/>
B			<input type="checkbox"/>		<input type="checkbox"/>	<input type="checkbox"/>
C			<input type="checkbox"/>		<input type="checkbox"/>	<input type="checkbox"/>
D			<input type="checkbox"/>		<input type="checkbox"/>	<input type="checkbox"/>





Example 11.10

- Northern Lights Expeditions, Inc.
- Nora – 25% shareholder
- \$25,000 ordinary loss
- \$50,000 distribution
- Form 7203 is Required

Completing Form 7203

- Part I – Shareholder Stock Basis
- Part II – Shareholder Debt Basis
- Part III – Shareholder Allowable Loss & Deduction Items
- Separate Form 7203 per Schedule K-1
- Separate Form 7203 per block of stock
- Separate Form 7203 per partial stock sale or redemption

Example 11.11 – Loss is Not Limited

- Facts are the same as 11.10
- Nora's stock basis \$90,000
- Adjusted basis = \$ 0,000
 - $90,000 - 50,000$
- Year-end stock basis = \$15,000
 - $40,000 - 25,000$
- Loss is allowed

FIGURE 11.7. Nora Johansson's Form 7203—Loss Is Not Limited

Form 7203
 (Rev. December 2022)
 Department of the Treasury
 Internal Revenue Service

S Corporation Shareholder Stock and Debt Basis Limitations
 Attach to your tax return.
 Go to www.irs.gov/Form7203 for instructions and the latest information.

OMB No. 1545-2302
 Attachment Sequence No. **203**

Name of shareholder
Nora Johansson

A Name of S corporation
Northern Lights Expeditions, Inc.

C Stock block (see instructions):

D Check applicable box(es) to indicate how stock was acquired:
 (1) Original shareholder (2) Purchased (3) Inherited (4) Gift (5) Other

E Check if you have a Regulations section 1.1367-1(g) election in effect during the tax year for this S corporation

Part I Shareholder Stock Basis

1	Stock basis at the beginning of the corporation's tax year	1	90,000
2	Basis from any capital contributions made or additional stock acquired during the tax year	2	
3a	Ordinary business income (enter losses in Part III)	3a	
b	Net rental real estate income (enter losses in Part III)	3b	
c	Other net rental income (enter losses in Part III)	3c	
d	Interest income	3d	
e	Ordinary dividends	3e	
f	Royalties	3f	
g	Net capital gains (enter losses in Part III)	3g	
h	Net section 1231 gain (enter losses in Part III)	3h	
i	Other income (enter losses in Part III)	3i	
j	Excess depletion adjustment	3j	
k	Tax-exempt income	3k	
l	Recapture of business credits	3l	
m	Other items that increase stock basis	3m	
4	Add lines 3a through 3m	4	0
5	Stock basis before distributions. Add lines 1, 2, and 4	5	90,000
6	Distributions (excluding dividend distributions) Note: If line 6 is larger than line 5, subtract line 5 from line 6 and report the result as a capital gain on Form 8949 and Schedule D. See instructions.	6	50,000
7	Stock basis after distributions. Subtract line 6 from line 5. If the result is zero or less, enter -0-, skip lines 8 through 14, and enter -0- on line 15	7	40,000
8a	Nondeductible expenses	8a	
b	Depletion for oil and gas	8b	
c	Business credits (sections 50(c)(1) and (5))	8c	
9	Add lines 8a through 8c	9	0
10	Stock basis before loss and deduction items. Subtract line 9 from line 7. If the result is zero or less, enter -0-, skip lines 11 through 14, and enter -0- on line 15	10	40,000
11	Allowable loss and deduction items. Enter the amount from line 47, column (c)	11	25,000
12	Debt basis restoration (see net increase in instructions for line 23)	12	
13	Other items that decrease stock basis	13	
14	Add lines 11, 12, and 13	14	25,000
15	Stock basis at the end of the corporation's tax year. Subtract line 14 from line 10. If the result is zero or less, enter -0-	15	15,000

Part II Shareholder Debt Basis

Section A—Amount of Debt (If more than three debts, see instructions.)

Description	(a) Debt 1	(b) Debt 2	(c) Debt 3	(d) Total
	<input type="checkbox"/> Formal note <input type="checkbox"/> Open account	<input type="checkbox"/> Formal note <input type="checkbox"/> Open account	<input type="checkbox"/> Formal note <input type="checkbox"/> Open account	
16 Loan balance at the beginning of the corporation's tax year				
17 Additional loans (see instructions)				
18 Loan balance before repayment. Add lines 16 and 17				
19 Principal portion of debt repayment (this line doesn't include interest)				
20 Loan balance at the end of the corporation's tax year. Subtract line 19 from line 18				

Part II Shareholder Debt Basis (continued)					
Section B—Adjustments to Debt Basis					
Description	(a) Debt 1	(b) Debt 2	(c) Debt 3	(d) Total	
21 Debt basis at the beginning of the corporation's tax year					
22 Enter the amount, if any, from line 17					
23 Debt basis restoration (see instructions)					
24 Debt basis before repayment. Add lines 21, 22, and 23					
25 Divide line 24 by line 18					
26 Nontaxable debt repayment. Multiply line 25 by line 19					
27 Debt basis before nondeductible expenses and losses. Subtract line 26 from line 24					
28 Nondeductible expenses and oil and gas depletion deductions in excess of stock basis					
29 Debt basis before losses and deductions. Subtract line 28 from line 27. If the result is zero or less, enter -0-					
30 Allowable losses in excess of stock basis. Enter the amount from line 47, column (d)					
31 Debt basis at the end of the corporation's tax year. Subtract line 30 from line 29. If the result is zero or less, enter -0-					
Section C—Gain on Loan Repayment					
32 Repayment. Enter the amount from line 19					
33 Nontaxable repayments. Enter the amount from line 26					
34 Reportable gain. Subtract line 33 from line 32					
Part III Shareholder Allowable Loss and Deduction Items					
Description	(a) Current year losses and deductions	(b) Carryover amounts (column (e)) from the previous year	(c) Allowable loss from stock basis	(d) Allowable loss from debt basis	(e) Carryover amounts
35 Ordinary business loss	25,000		25,000		
36 Net rental real estate loss					
37 Other net rental loss					
38 Net capital loss					
39 Net section 1231 loss					
40 Other loss					
41 Section 179 deductions					
42 Charitable contributions					
43 Investment interest expense					
44 Section 59(e)(2) expenditures					
45 Other deductions					
46 Foreign taxes paid or accrued					
47 Total loss. Add lines 35 through 46 for each column. Enter the total loss in column (c) on line 11 and enter the total loss in column (d) on line 30	25,000		25,000		

Example 11.12 – Loss is Limited

- Northern Lights Expeditions
- Ola – 25% shareholder
- \$25,000 ordinary loss
- \$50,000 distribution
- \$60,000 stock basis
- Year-end stock basis = \$0
- Carryover loss = \$15,000

7203
 Form 7203 (Rev. December 2022)
 Department of the Treasury
 Internal Revenue Service

S Corporation Shareholder Stock and Debt Basis Limitations
 Attach to your tax return.
 Go to www.irs.gov/Form7203 for instructions and the latest information.

OMB No. 1545-2302
 Attachment Sequence No. **203**

Name of shareholder: **Ola Torgersen**
 Identifying number: **XXX-XX-XXXX**

A Name of S corporation: **Northern Lights Expeditions, Inc.**
 Employer identification number: **XX-XXXXXXX**

C Stock block (see instructions):

D Check applicable box(es) to indicate how stock was acquired:
 (1) Original shareholder (2) Purchased (3) Inherited (4) Gift (5) Other:

E Check if you have a Regulations section 1.1367-1(g) election in effect during the tax year for this S corporation:

Part I Shareholder Stock Basis

1	Stock basis at the beginning of the corporation's tax year	1	60,000
2	Basis from any capital contributions made or additional stock acquired during the tax year	2	
3a	Ordinary business income (enter losses in Part III)	3a	
b	Net rental real estate income (enter losses in Part III)	3b	
c	Other net rental income (enter losses in Part III)	3c	
d	Interest income	3d	
e	Ordinary dividends	3e	
f	Royalties	3f	
g	Net capital gains (enter losses in Part III)	3g	
h	Net section 1231 gain (enter losses in Part III)	3h	
i	Other income (enter losses in Part III)	3i	
j	Excess depletion adjustment	3j	
k	Tax-exempt income	3k	
l	Recapture of business credits	3l	
m	Other items that increase stock basis	3m	
4	Add lines 3a through 3m	4	0
5	Stock basis before distributions. Add lines 1, 2, and 4	5	60,000
6	Distributions (excluding dividend distributions) <i>Note: If line 6 is larger than line 5, subtract line 5 from line 6 and report the result as a capital gain on Form 8949 and Schedule D. See instructions.</i>	6	50,000
7	Stock basis after distributions. Subtract line 6 from line 5. If the result is zero or less, enter -0-, skip lines 8 through 14, and enter -0- on line 15	7	10,000
8a	Nondeductible expenses	8a	
b	Depletion for oil and gas	8b	
c	Business credits (sections 50(c)(1) and (5))	8c	
9	Add lines 8a through 8c	9	0
10	Stock basis before loss and deduction items. Subtract line 9 from line 7. If the result is zero or less, enter -0-, skip lines 11 through 14, and enter -0- on line 15	10	10,000
11	Allowable loss and deduction items. Enter the amount from line 47, column (c)	11	10,000
12	Debt basis restoration (see net increase in instructions for line 23)	12	
13	Other items that decrease stock basis	13	
14	Add lines 11, 12, and 13	14	10,000
15	Stock basis at the end of the corporation's tax year. Subtract line 14 from line 10. If the result is zero or less, enter -0-	15	0

Part II Shareholder Debt Basis

Section A—Amount of Debt (if more than three debts, see instructions.)

Description	(a) Debt 1	(b) Debt 2	(c) Debt 3	(d) Total
	<input type="checkbox"/> Formal note <input type="checkbox"/> Open account	<input type="checkbox"/> Formal note <input type="checkbox"/> Open account	<input type="checkbox"/> Formal note <input type="checkbox"/> Open account	
16	Loan balance at the beginning of the corporation's tax year			
17	Additional loans (see instructions)			
18	Loan balance before repayment. Add lines 16 and 17			
19	Principal portion of debt repayment (this line doesn't include interest)			
20	Loan balance at the end of the corporation's tax year. Subtract line 19 from line 18			

Part II Shareholder Debt Basis (continued)

Section B—Adjustments to Debt Basis

Description	(a) Debt 1	(b) Debt 2	(c) Debt 3	(d) Total
21	Debt basis at the beginning of the corporation's tax year			
22	Enter the amount, if any, from line 17			
23	Debt basis restoration (see instructions)			
24	Debt basis before repayment. Add lines 21, 22, and 23			
25	Divide line 24 by line 18			
26	Nontaxable debt repayment. Multiply line 25 by line 19			
27	Debt basis before nondeductible expenses and losses. Subtract line 26 from line 24			
28	Nondeductible expenses and oil and gas depletion deductions in excess of stock basis			
29	Debt basis before losses and deductions. Subtract line 28 from line 27. If the result is zero or less, enter -0-			
30	Allowable losses in excess of stock basis. Enter the amount from line 47, column (d)			
31	Debt basis at the end of the corporation's tax year. Subtract line 30 from line 29. If the result is zero or less, enter -0-			

Section C—Gain on Loan Repayment

32	Repayment. Enter the amount from line 19			
33	Nontaxable repayments. Enter the amount from line 26			
34	Reportable gain. Subtract line 33 from line 32			

Part III Shareholder Allowable Loss and Deduction Items

Description	(a) Current year losses and deductions	(b) Carryover amounts (column (e)) from the previous year	(c) Allowable loss from stock basis	(d) Allowable loss from debt basis	(e) Carryover amounts
35	Ordinary business loss	25,000	10,000		15,000
36	Net rental real estate loss				
37	Other net rental loss				
38	Net capital loss				
39	Net section 1231 loss				
40	Other loss				
41	Section 179 deductions				
42	Charitable contributions				
43	Investment interest expense				
44	Section 59(e)(2) expenditures				
45	Other deductions				
46	Foreign taxes paid or accrued				
47	Total loss. Add lines 35 through 46 for each column. Enter the total loss in column (c) on line 11 and enter the total loss in column (d) on line 30	25,000	10,000		15,000

Example 11.13 – Loss Allowed by Debt Basis

- Facts same as Example 11.12
- Promissory note \$40,000 loan to corp.
- 5-year maturity
- Interest only

Form **7203**
(Rev. December 2022)
Department of the Treasury
Internal Revenue Service

S Corporation Shareholder Stock and Debt Basis Limitations
Attach to your tax return.
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OMB No. 1545-2302
Attachment Sequence No. **203**

Name of shareholder
Ola Torgersen
A Name of S corporation
Northern Lights Expeditions, Inc.
C Stock block (see instructions):
D Check applicable box(es) to indicate how stock was acquired:
(1) Original shareholder (2) Purchased (3) Inherited (4) Gift (5) Other:
E Check if you have a Regulations section 1.1367-1(g) election in effect during the tax year for this S corporation

Part I Shareholder Stock Basis

	1	2	3a	3b	3c	3d	3e	3f	3g	3h	3i	3j	3k	3l	3m	4	5	6	7	8a	8b	8c	9	10	11	12	13	14	15
1	Stock basis at the beginning of the corporation's tax year	60,000																											
2	Basis from any capital contributions made or additional stock acquired during the tax year																												
3a	Ordinary business income (enter losses in Part III)																												
b	Net rental real estate income (enter losses in Part III)																												
c	Other net rental income (enter losses in Part III)																												
d	Interest income																												
e	Ordinary dividends																												
f	Royalties																												
g	Net capital gains (enter losses in Part III)																												
h	Net section 1231 gain (enter losses in Part III)																												
i	Other income (enter losses in Part III)																												
j	Excess depletion adjustment																												
k	Tax-exempt income																												
l	Recapture of business credits																												
m	Other items that increase stock basis																												
4	Add lines 3a through 3m	0																											
5	Stock basis before distributions. Add lines 1, 2, and 4	60,000																											
6	Distributions (excluding dividend distributions)	50,000																											
Note: If line 6 is larger than line 5, subtract line 5 from line 6 and report the result as a capital gain on Form 8949 and Schedule D. See instructions.																													
7	Stock basis after distributions. Subtract line 6 from line 5. If the result is zero or less, enter -0-, skip lines 8 through 14, and enter -0- on line 15	10,000																											
8a	Nondeductible expenses																												
b	Depletion for oil and gas																												
c	Business credits (sections 50(c)(1) and (5))																												
9	Add lines 8a through 8c	0																											
10	Stock basis before loss and deduction items. Subtract line 9 from line 7. If the result is zero or less, enter -0-, skip lines 11 through 14, and enter -0- on line 15	10,000																											
11	Allowable loss and deduction items. Enter the amount from line 47, column (c)	10,000																											
12	Debt basis restoration (see net increase in instructions for line 23)																												
13	Other items that decrease stock basis																												
14	Add lines 11, 12, and 13	10,000																											
15	Stock basis at the end of the corporation's tax year. Subtract line 14 from line 10. If the result is zero or less, enter -0-	0																											

Part II Shareholder Debt Basis

Section A—Amount of Debt (If more than three debts, see instructions.)

Description	(a) Debt 1		(b) Debt 2		(c) Debt 3		(d) Total
	<input checked="" type="checkbox"/> Formal note <input type="checkbox"/> Open account	<input type="checkbox"/> Formal note <input type="checkbox"/> Open account	<input type="checkbox"/> Formal note <input type="checkbox"/> Open account	<input type="checkbox"/> Formal note <input type="checkbox"/> Open account			
16	Loan balance at the beginning of the corporation's tax year	40,000					40,000
17	Additional loans (see instructions)						
18	Loan balance before repayment. Add lines 16 and 17	40,000					40,000
19	Principal portion of debt repayment (this line doesn't include interest)	0					0
20	Loan balance at the end of the corporation's tax year. Subtract line 19 from line 18	40,000					40,000

Part II Shareholder Debt Basis (continued)

Section B—Adjustments to Debt Basis

Description	(a) Debt 1	(b) Debt 2	(c) Debt 3	(d) Total
21	Debt basis at the beginning of the corporation's tax year	40,000		40,000
22	Enter the amount, if any, from line 17			
23	Debt basis restoration (see instructions)			
24	Debt basis before repayment. Add lines 21, 22, and 23	40,000		40,000
25	Divide line 24 by line 18	1		
26	Nontaxable debt repayment. Multiply line 25 by line 19			1
27	Debt basis before nondeductible expenses and losses. Subtract line 26 from line 24	40,000		40,000
28	Nondeductible expenses and oil and gas depletion deductions in excess of stock basis			
29	Debt basis before losses and deductions. Subtract line 28 from line 27. If the result is zero or less, enter -0-	40,000		40,000
30	Allowable losses in excess of stock basis. Enter the amount from line 47, column (d)	15,000		15,000
31	Debt basis at the end of the corporation's tax year. Subtract line 30 from line 29. If the result is zero or less, enter -0-	25,000		25,000

Section C—Gain on Loan Repayment

32	Repayment. Enter the amount from line 19			
33	Nontaxable repayments. Enter the amount from line 26			
34	Reportable gain. Subtract line 33 from line 32			

Part III Shareholder Allowable Loss and Deduction Items

Description	(a) Current year losses and deductions	(b) Carryover amounts (column (e)) from the previous year	(c) Allowable loss from stock basis	(d) Allowable loss from debt basis	(e) Carryover amounts
35	Ordinary business loss	25,000	10,000	15,000	
36	Net rental real estate loss				
37	Other net rental loss				
38	Net capital loss				
39	Net section 1231 loss				
40	Other loss				
41	Section 179 deductions				
42	Charitable contributions				
43	Investment interest expense				
44	Section 59(e)(2) expenditures				
45	Other deductions				
46	Foreign taxes paid or accrued				
47	Total loss. Add lines 35 through 46 for each column. Enter the total loss in column (c) on line 11 and enter the total loss in column (d) on line 30	25,000	10,000	15,000	

Example 11.14 – Restoration of Debt Basis

- Facts are same as Example 11.13
- Ordinary income \$150,000
- \$60,000 distribution
- Ordering to restore debt
 - Income offsets the distribution
 - Restores debt to original face value
 - Increase stock basis

Part II Shareholder Debt Basis (continued)

Section B—Adjustments to Debt Basis				
Description	(a) Debt 1	(b) Debt 2	(c) Debt 3	(d) Total
21 Debt basis at the beginning of the corporation's tax year	25,000			25,000
22 Enter the amount, if any, from line 17				
23 Debt basis restoration (see instructions)	15,000			15,000
24 Debt basis before repayment. Add lines 21, 22, and 23	40,000			40,000
25 Divide line 24 by line 18	1			
26 Nontaxable debt repayment. Multiply line 25 by line 19				
27 Debt basis before nondeductible expenses and losses. Subtract line 26 from line 24	40,000			40,000
28 Nondeductible expenses and oil and gas depletion deductions in excess of stock basis				
29 Debt basis before losses and deductions. Subtract line 28 from line 27. If the result is zero or less, enter -0-	40,000			40,000
30 Allowable losses in excess of stock basis. Enter the amount from line 47, column (d)				
31 Debt basis at the end of the corporation's tax year. Subtract line 30 from line 29. If the result is zero or less, enter -0-	40,000			40,000

Section C—Gain on Loan Repayment				
32 Repayment. Enter the amount from line 19				
33 Nontaxable repayments. Enter the amount from line 26				
34 Reportable gain. Subtract line 33 from line 32				

Part III Shareholder Allowable Loss and Deduction Items

Description	(a) Current year losses and deductions	(b) Carryover amounts (column (e)) from the previous year	(c) Allowable loss from stock basis	(d) Allowable loss from debt basis	(e) Carryover amounts
35 Ordinary business loss					
36 Net rental real estate loss					
37 Other net rental loss					
38 Net capital loss					
39 Net section 1231 loss					
40 Other loss					
41 Section 179 deductions					
42 Charitable contributions					
43 Investment interest expense					
44 Section 59(e)(2) expenditures					
45 Other deductions					
46 Foreign taxes paid or accrued					
47 Total loss. Add lines 35 through 46 for each column. Enter the total loss in column (c) on line 11 and enter the total loss in column (d) on line 30					

Form **7203**

(Rev. December 2022)
Department of the Treasury
Internal Revenue Service

S Corporation Shareholder Stock and Debt Basis Limitations

OMB No. 1545-2302

Attachment Sequence No. **203**

Attach to your tax return.

Go to www.irs.gov/Form7203 for instructions and the latest information.

Name of shareholder Ola Torgersen	Identifying number XXX-XX-XXXX
A Name of S corporation Northern Lights Expeditions, Inc.	B Employer identification number XX-XXXXXXX

C Stock block (see instructions):

D Check applicable box(es) to indicate how stock was acquired:
 (1) Original shareholder (2) Purchased (3) Inherited (4) Gift (5) Other:

E Check if you have a Regulations section 1.1367-1(g) election in effect during the tax year for this S corporation

Part I Shareholder Stock Basis

1 Stock basis at the beginning of the corporation's tax year	1	0
2 Basis from any capital contributions made or additional stock acquired during the tax year	2	
3a Ordinary business income (enter losses in Part III)	3a	150,000
b Net rental real estate income (enter losses in Part III)	3b	
c Other net rental income (enter losses in Part III)	3c	
d Interest income	3d	
e Ordinary dividends	3e	
f Royalties	3f	
g Net capital gains (enter losses in Part III)	3g	
h Net section 1231 gain (enter losses in Part III)	3h	
i Other income (enter losses in Part III)	3i	
j Excess depletion adjustment	3j	
k Tax-exempt income	3k	
l Recapture of business credits	3l	
m Other items that increase stock basis	3m	
4 Add lines 3a through 3m	4	150,000
5 Stock basis before distributions. Add lines 1, 2, and 4	5	150,000
6 Distributions (excluding dividend distributions)	6	60,000
Note: If line 6 is larger than line 5, subtract line 5 from line 6 and report the result as a capital gain on Form 8949 and Schedule D. See instructions.		
7 Stock basis after distributions. Subtract line 6 from line 5. If the result is zero or less, enter -0-, skip lines 8 through 14, and enter -0- on line 15	7	90,000
8a Nondeductible expenses	8a	
b Depletion for oil and gas	8b	
c Business credits (sections 50(c)(1) and (5))	8c	
9 Add lines 8a through 8c	9	0
10 Stock basis before loss and deduction items. Subtract line 9 from line 7. If the result is zero or less, enter -0-, skip lines 11 through 14, and enter -0- on line 15	10	90,000
11 Allowable loss and deduction items. Enter the amount from line 47, column (c)	11	
12 Debt basis restoration (see net increase in instructions for line 23)	12	15,000
13 Other items that decrease stock basis	13	
14 Add lines 11, 12, and 13	14	15,000
15 Stock basis at the end of the corporation's tax year. Subtract line 14 from line 10. If the result is zero or less, enter -0-	15	75,000

Part II Shareholder Debt Basis

Section A—Amount of Debt (If more than three debts, see instructions.)

Description	(a) Debt 1	(b) Debt 2	(c) Debt 3	(d) Total
	<input checked="" type="checkbox"/> Formal note <input type="checkbox"/> Open account	<input type="checkbox"/> Formal note <input type="checkbox"/> Open account	<input type="checkbox"/> Formal note <input type="checkbox"/> Open account	
16 Loan balance at the beginning of the corporation's tax year	40,000			40,000
17 Additional loans (see instructions)				
18 Loan balance before repayment. Add lines 16 and 17	40,000			40,000
19 Principal portion of debt repayment (this line doesn't include interest)	0			
20 Loan balance at the end of the corporation's tax year. Subtract line 19 from line 18	40,000			40,000

Example 11.15 Principal Payment on Reduced Basis Loan

- Facts are same as Example 11.14
- No taxable income or loss
- No distributions to Ola
- Corporate commercial financing & pays off \$30,000 of Ola's loan
- Long-term capital gain \$11,250
 - Form 8949 (1040)
 - Schedule D (1040)

Form **7203**
(Rev. December 2022)
Department of the Treasury
Internal Revenue Service

S Corporation Shareholder Stock and Debt Basis Limitations

OMB No. 1545-2302
Attachment Sequence No. **203**

Attach to your tax return.
Go to www.irs.gov/Form7203 for instructions and the latest information.

Name of shareholder: **Ola Torgersen**
Identifying number: **XXX-XX-XXXX**
A Name of S corporation: **Northern Lights Expeditions, Inc.**
B Employer identification number: **XX-XXXXXX**
C Stock block (see instructions):
D Check applicable box(es) to indicate how stock was acquired:
(1) Original shareholder (2) Purchased (3) Inherited (4) Gift (5) Other:
E Check if you have a Regulations section 1.1367-1(g) election in effect during the tax year for this S corporation

Part I Shareholder Stock Basis

1	Stock basis at the beginning of the corporation's tax year	1	
2	Basis from any capital contributions made or additional stock acquired during the tax year	2	
3a	Ordinary business income (enter losses in Part III)	3a	
b	Net rental real estate income (enter losses in Part III)	3b	
c	Other net rental income (enter losses in Part III)	3c	
d	Interest income	3d	
e	Ordinary dividends	3e	
f	Royalties	3f	
g	Net capital gains (enter losses in Part III)	3g	
h	Net section 1231 gain (enter losses in Part III)	3h	
i	Other income (enter losses in Part III)	3i	
j	Excess depletion adjustment	3j	
k	Tax-exempt income	3k	
l	Recapture of business credits	3l	
m	Other items that increase stock basis	3m	
4	Add lines 3a through 3m	4	
5	Stock basis before distributions. Add lines 1, 2, and 4	5	
6	Distributions (excluding dividend distributions) Note: If line 6 is larger than line 5, subtract line 5 from line 6 and report the result as a capital gain on Form 8949 and Schedule D. See instructions.	6	
7	Stock basis after distributions. Subtract line 6 from line 5. If the result is zero or less, enter -0-, skip lines 8 through 14, and enter -0- on line 15	7	
8a	Nondeductible expenses	8a	
b	Depletion for oil and gas	8b	
c	Business credits (sections 50(c)(1) and (5))	8c	
9	Add lines 8a through 8c	9	
10	Stock basis before loss and deduction items. Subtract line 9 from line 7. If the result is zero or less, enter -0-, skip lines 11 through 14, and enter -0- on line 15	10	
11	Allowable loss and deduction items. Enter the amount from line 47, column (c)	11	
12	Debt basis restoration (see net increase in instructions for line 23)	12	
13	Other items that decrease stock basis	13	
14	Add lines 11, 12, and 13	14	
15	Stock basis at the end of the corporation's tax year. Subtract line 14 from line 10. If the result is zero or less, enter -0-	15	

Part II Shareholder Debt Basis

Section A—Amount of Debt (If more than three debts, see instructions.)

Description	(a) Debt 1	(b) Debt 2	(c) Debt 3	(d) Total
	<input checked="" type="checkbox"/> Formal note <input type="checkbox"/> Open account	<input type="checkbox"/> Formal note <input type="checkbox"/> Open account	<input type="checkbox"/> Formal note <input type="checkbox"/> Open account	
16 Loan balance at the beginning of the corporation's tax year	40,000			40,000
17 Additional loans (see instructions)				
18 Loan balance before repayment. Add lines 16 and 17	40,000			40,000
19 Principal portion of debt repayment (this line doesn't include interest)	30,000			30,000
20 Loan balance at the end of the corporation's tax year. Subtract line 19 from line 18	10,000			10,000

Part II Shareholder Debt Basis (continued)

Section B—Adjustments to Debt Basis 406

Description	(a) Debt 1	(b) Debt 2	(c) Debt 3	(d) Total
21 Debt basis at the beginning of the corporation's tax year	25,000			25,000
22 Enter the amount, if any, from line 17				
23 Debt basis restoration (see instructions)				
24 Debt basis before repayment. Add lines 21, 22, and 23	25,000			25,000
25 Divide line 24 by line 18	0.625			
26 Nontaxable debt repayment. Multiply line 25 by line 19	18,750			18,750
27 Debt basis before nondeductible expenses and losses. Subtract line 26 from line 24	6,250			6,250
28 Nondeductible expenses and oil and gas depletion deductions in excess of stock basis				
29 Debt basis before losses and deductions. Subtract line 28 from line 27. If the result is zero or less, enter -0-	6,250			6,250
30 Allowable losses in excess of stock basis. Enter the amount from line 47, column (d)				
31 Debt basis at the end of the corporation's tax year. Subtract line 30 from line 29. If the result is zero or less, enter -0-	6,250			6,250

Section C—Gain on Loan Repayment

32 Repayment. Enter the amount from line 19	30,000			30,000
33 Nontaxable repayments. Enter the amount from line 26	18,750			18,750
34 Reportable gain. Subtract line 33 from line 32	11,250			11,250

Part III Shareholder Allowable Loss and Deduction Items

Description	(a) Current year losses and deductions	(b) Carryover amounts (column (e)) from the previous year	(c) Allowable loss from stock basis	(d) Allowable loss from debt basis	(e) Carryover amounts
35 Ordinary business loss					
36 Net rental real estate loss					
37 Other net rental loss					
38 Net capital loss					
39 Net section 1231 loss					
40 Other loss					
41 Section 179 deductions					
42 Charitable contributions					
43 Investment interest expense					
44 Section 59(e)(2) expenditures					
45 Other deductions					
46 Foreign taxes paid or accrued					
47 Total loss. Add lines 35 through 46 for each column. Enter the total loss in column (c) on line 11 and enter the total loss in column (d) on line 30					

Issue 3: Fixing S Corporation Eligibility Errors

Rev. Proc. 2022-19, 2022-41 I.R.B. 282

Procedures for S corporation



Procedures for S corporation shareholders



Resolve frequently encountered issues without a private letter ruling



Relief for inadvertent invalid S elections/terminations



Minimize taxpayer burden

Eligibility – small business corporation

Not more than
100
shareholders

No shareholder
who is not an
individual

No nonresident
alien
shareholder

Not more than
one class of
stock

Qsub – parent S
corporation
must qualify

Cross-Reference
– Eligible
Shareholders

S & Q Sub Elections

Timely file elections

Form 2553, Election by a Small Business Corporation

Form 8869, Qualified Subchapter S Subsidiary Election

15th day of third month of tax year for which election is to take effect

Ineffective or Terminated S or QSub Election

Not eligible for elections

Terminated or Revoked

- Voluntary or involuntary
- Ceases
- Passive Investment Income > 25% of gross receipts for 3 consecutive year
- Accumulated E & P for 3 consecutive years

Subsidiary not eligible

Transfer of 100% of QSub stock to non-qualifying entity

Relief from Inadvertent or Invalid Elections

- 1362(f) relief from defective elections & inadvertent terminations
- Reasonable time after discovery
- Taxpayer takes remediation steps
- Each shareholder must agree
- May request relief by submitting PLR

Rev. Proc. 2022-19 Procedure

Resolution without
PLR

One class of stock
with governing
provisions

Disproportionate
distributions

Certain inadvertent
errors or omissions
on Form 2553 or
Form 8869

Missing
administrative
acceptance letter
of S election or
Qsub election

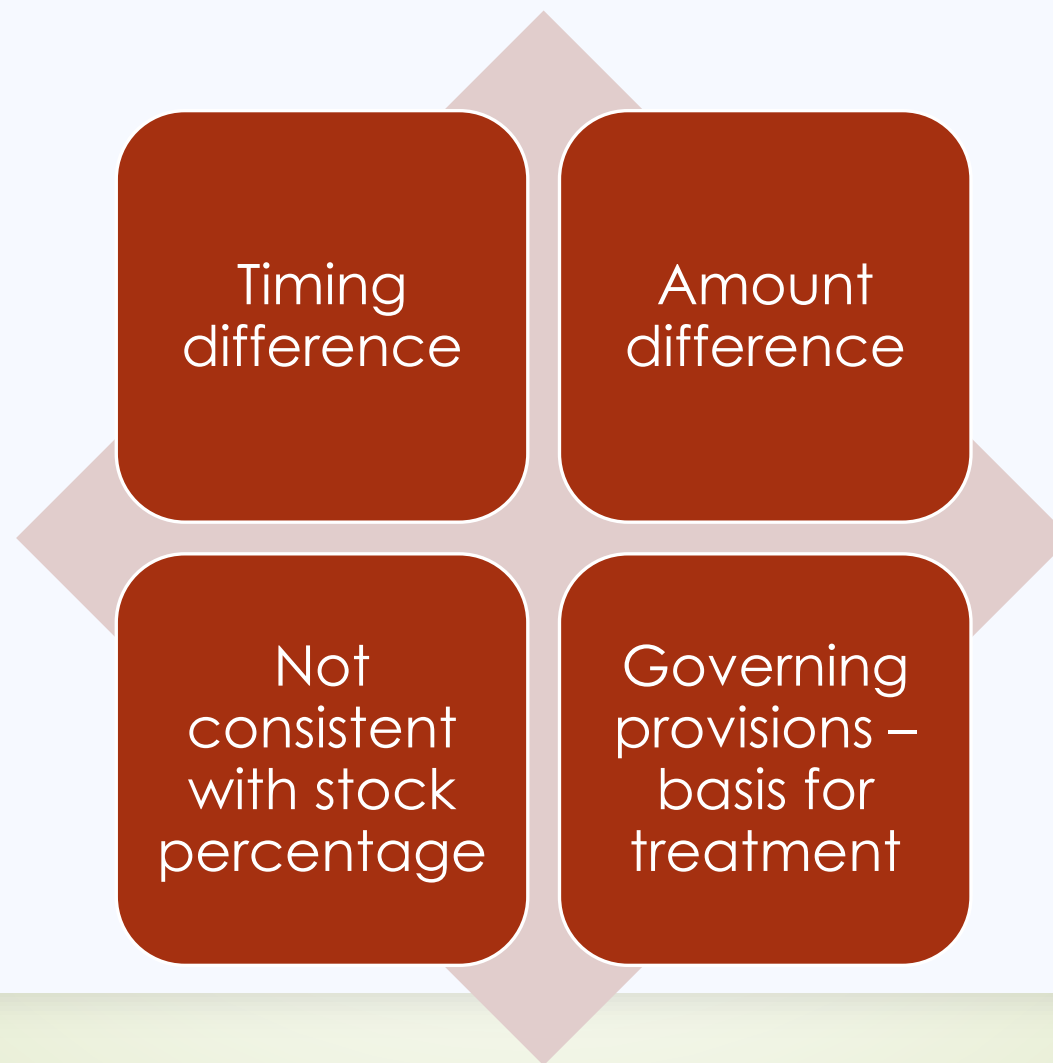
A federal income
tax return filing
inconsistent with an
S election or Qsub

Nonidentical
governing
provisions

One Class of Stock Requirement

- Identical rights to distributions & liquidation
- Based upon:
 - Corporate charter
 - Articles of incorporation
 - Bylaws
 - Applicable state law
 - Binding agreements (governing provisions)
 - Buy-sell agreements – Example 11.16
- No principal purpose to circumvent the one class of stock requirement

Disproportionate Distributions



Inadvertent Errors or Omissions

- Missing Shareholder Consent
 - Shareholders at time of consent
 - Corrective measures
 - Treas. Reg. 1.1362-6(b)(3(iii)) – extension of time to file
 - Rev. Proc. 2013-30 – simplified method to request relief
 - Rev. Proc. 2004-35, 2004-1 C.B. 1029 automatic relief
 - PLR request for other relief

Inadvertent Errors or Omissions

- Permitted-year Errors
 - Rev. Proc. 2013-30
 - PLR request for relief



Inadvertent Errors or Omissions

- Missing Officer's Signature
 - Rev. Proc. 2013-30
 - PLR request for relief
- Other errors or omissions
 - Written explanation
 - IRS Service Center

Inadvertent Errors or Omissions

- Missing Administrative Acceptance Letter
 - 90 days after IRS receives Form 2553
 - CP 279 Notice to Filer
 - CP 279A Notice to Subsidiary
- Lack of written acknowledgment does not affect the validity of the election

Inadvertent Errors or Omissions

- Inconsistent Federal Income Tax Filing
 - Filing does not affect validity of S election or Qsub election
 - File correct return of open years
 - IRS will not issue PLR
- Nonidentical Governing Provisions
 - More than one class of stock
 - Invalid S election
 - Termination of S election

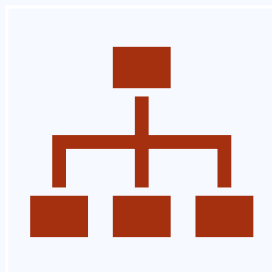


Nonidentical Governing Provisions Corrective Relief

- One or more nonidentical governing provisions
- Has not made, has not deemed to have made, a disproportionate distribution to an applicable shareholder
- Timely filed a return on Form 1120-S for each tax year affected
- Before the IRS discovers
- Completes a Corporate Governing Provision Statement and a Shareholder Statement for each applicable shareholder [Appendices A & B of Rev. Proc. 2022-19]

Section 4. Required Representations or Explanation of the Corporation

1. Except as provided by Section 5 of this Corporate Governing Provision Statement, provide the following representations required by section 3.06(2)(c)(ii)(C) and (D) of Rev. Proc. 2022-19:
 - A. The Corporation's S election was inadvertently invalid or terminated solely because of the adoption of one or more non-identical governing provisions.
 - B. The Corporation and each applicable shareholder satisfy all of the requirements set forth in section 3.06 of Rev. Proc. 2022-19.
 - C. Except as provided by section 4.2 of this Corporate Governing Provision Statement, the Corporation responds in the negative to each requested statement set forth in section 7.01(4) or (5) of Rev. Proc. 2022-1, 2022-1 I.R.B. 1, or any successor revenue procedure (statements regarding whether the same or a similar issue was previously ruled on or whether a request involving the same or a similar issue was submitted or is currently pending).
 - D. The corporation and each applicable shareholder acted reasonably and in good faith in correcting or removing each non-identical governing provision upon discovery.
2. Required Explanation. If the Corporation has a positive response to any requested statement set forth in section 7.01(4) or (5) of Rev. Proc. 2022-1 (or any successor revenue procedure), the Corporation must provide an explanation for each such response as part of the description of all relevant facts required by section 3.06(2)(c)(ii)(B)(4) of Rev. Proc. 2022-19.



Example 11.17 –
Nonidentical
Governing
Provision



Practitioner
Note – Letter
Rulings



Practitioner
Note – AICPA
Recommendati
ons

► Business leagues, chambers of commerce, real estate boards, boards of trade & football leagues are eligible for tax-exempt status:

► True

► False

Polling Question # 3

Issue 4: I.R.C. §501 (c) (6)
Business Leagues

Tax-exempt Business Leagues

Chambers
of
commerce

Real estate
boards

Boards of
trade

Professional
football
leagues

Not
organized
for profit

No private
inurement
benefit

Treas. Reg. 1.501(c)(6)-1

- Association of persons
- Common business interest
- Promote common interest
- No engaged in regular business ordinarily carried on for profit
- Improvement of business conditions
- Distinguish from performance of services for individual persons
- Practitioner Note – Formation & Application Process

Eligibility for Tax-Exempt Status



It must be an association of persons having a common business interest, and its purpose must be to promote this common business interest



It must be a membership organization and have a meaningful extent of membership support



It must not be organized for profit



No part of its net earnings may inure to the benefit of any private shareholder or individual

Eligibility for Tax-Exempt Status

Its activities must be directed to the improvement of business conditions of one or more lines of business as distinguished from the performance of particular services for individual persons

Its primary activity cannot consist of performing particular services for individual persons

Its purpose must not be to engage in regular business of a kind ordinarily carried on for profit, even if the business is operated on a cooperative basis or produces only sufficient income to be self-sustaining

Qualifying Organizations



Medical specialty board



Nonprofit organization



Organization composed of persons studying for a degree

Qualifying Organizations

Organization composed of business persons whose activities are limited to holding luncheon meetings

Organization of business & professional women to promote the acceptance of women

Organization formed to promote the commercial fishing industry

Nonqualifying Organizations

National association
of individual auto
owners & affiliated
auto clubs

Organization that
promotes the
common interests of
hobbyist

Other Requirements

- Membership
 - Limited
 - Based on nature of business or industry
- Meaningful Support
 - Dues paid by members
 - Income from nonmembers – must be substantial
 - Income derived from performance of organizations' exempt function
 - Public contributions or gifts
 - Cannot be Unrelated Business Taxable Income
- Practitioner Note – Deducting Dues & Contributions

Private Inurement

When an individual or organization benefits from the income or assets of a tax-exempt organization



Private benefit rather than public benefit



Members can receive benefits

Excessive

Beyond the scope & function

Private Inurement Distributions to Members



An organization promoted an annual trade show



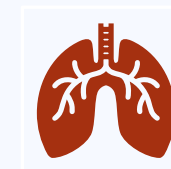
A business league was formed to improve business conditions in its members line of business



An organization was formed to protect & promote the chiropractic profession



An association of wholesale grocers



Practitioner Note – Inurement Consequences

Private Inurement Distributions to Members

- Not private inurement
 - Represent no more than a reduction in dues
 - Contributions previously paid to the organization
 - Equally to all members
- Nonmember Income

Private Inurement Distributions to Members

- Other Inurement Issues
 - Excessive compensation
 - Low-cost or no-cost
 - Sale of assets – arm's length & FMV
 - Loans – interest, written agreement
- Practitioner Note – Performance of Particular Services

Annual Tax Filing

Annual returns

Due 15th day of 5th month following close of calendar or fiscal year

6-month extension available

Form 990-N: gross receipts < \$50,000

Form 990-EZ: gross receipts < \$200,000 & total assets < \$500,000

Form 990: gross receipts > \$200,000 & total assets > \$500,000

Gross Receipts Defined – Received or Pledged

- Existence for 1 year or less
 - \$75,000 or less during the tax year
- Existence between 1 & 3 years
 - \$60,000 or less in gross receipts during each of its first 2 years
- At least 3 years old
 - \$50,000 or less in gross receipts for the immediately preceding 3 tax years (including the year for which calculations are being made).
- Practitioner Note – Unrelated Business Taxable Income

Automatic Revocation

- 3-years non-filing
- IRS Notice – CP-120A
- IRS Tax Exempt Organization Search Tool
- www.irs.gov/charities-non-profits/tax-exempt-organization-search

Reinstatement of Revoked Status

Must apply for reinstatement

Retroactive reinstatement

Form 1024,
Application for
Recognition of
Exemption

15 months from
date of
Revocation Letter
or

Date organization
appeared on
revocation list on
IRS website

Reinstatement of Revoked Status

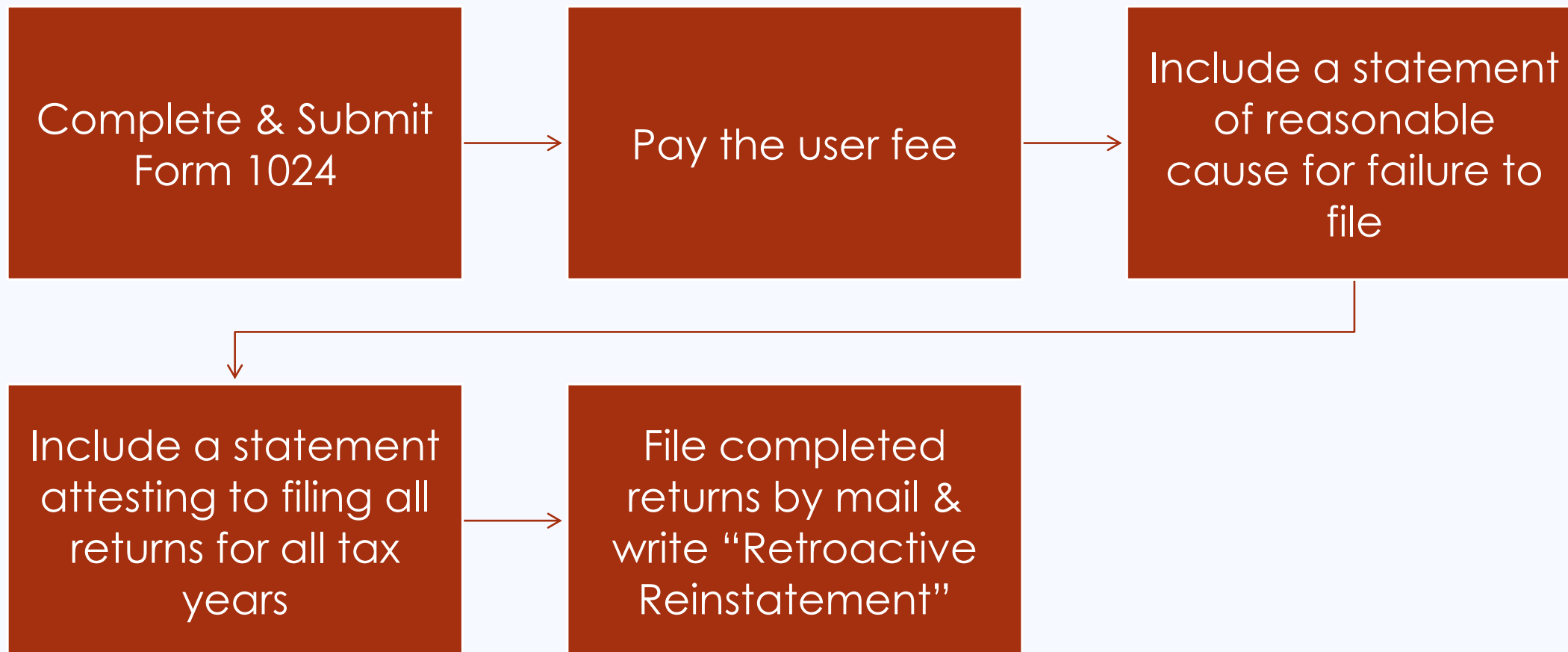
Penalty will not be imposed

File all returns

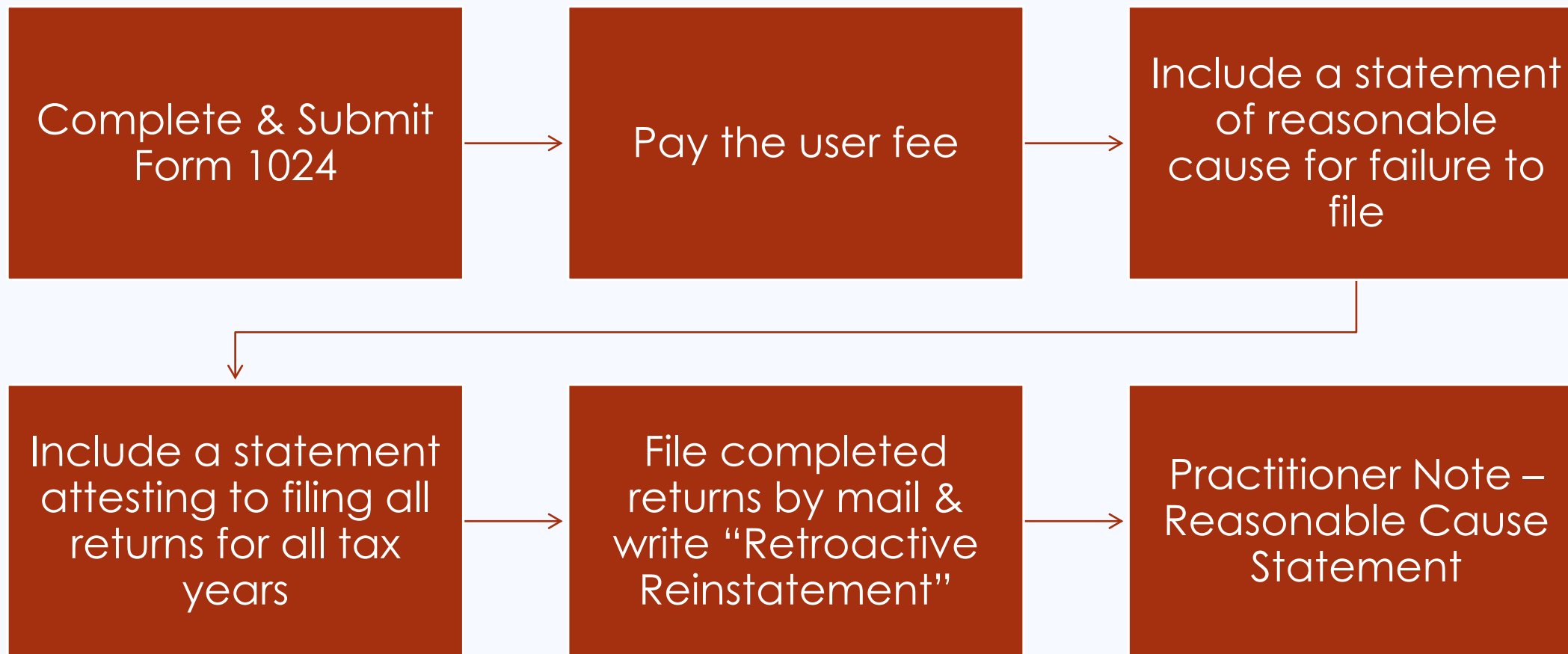
Write "Retroactive Reinstatement" on top of Form 990-series

Mail to: Dept. of Treasury, Internal Revenue Service, Ogden UT 84201-0027

Reinstatement within 15 months



Reinstatement after 15 months



Issue 5: Schedules K-2 & K-3

Overview

Attachment to Schedule K-1 – flow-through entities

Beginning tax years 2021

Transitional relief

Partner Claims Foreign Tax Credit

Foreign source income

Allocation & apportionment

Example 11.18 – Reporting for Foreign Tax Credit

Partnership Sale of Personal Property

Research & Experimental Expenses

Domestic Filing Exception

Filing & furnishing Schedule K-2 & K-3

Domestic Partnerships – no or limited foreign activities

No foreign partners

No or limited foreign activity

Domestic Filing Exception

Notice to partners or shareholders – can be with Schedule K-1



Partner or Shareholder Request – timely requests from entity

Domestic Filing Exception Tests

Test

Test #1 – No or Very Limited Foreign Activity

Test

Test #2 – Domestic Individual Partners (Applies to Partnerships Only)

Test

Test #3 – Notification of Partners or Shareholder

Test

Test #4 – Responses from Any Partner or Shareholder

Domestic Filing Exception Test # 1

No foreign income taxes paid or accrued

No foreign taxes withheld

No foreign source income, gains or losses

No ownership interest in a foreign entity

De minimis Rule \$300 – brokerage account income

Domestic Filing Exception Test # 2

Individuals who are a US citizens or resident aliens, or meet the substantial presence test

Domestic decedent's estates with only domestic individual beneficiaries

Domestic grantor trust with only domestic individual grantors and domestic individual beneficiaries

Domestic Filing Exception Test # 2

Domestic non-grantor trusts with only domestic individual beneficiaries

Sole shareholder S corporations

Single member LLC's (disregarded entities) owned by any of the preceding

If partnership is wholly or partially owned by another partnership or a corporation, it CANNOT use the Domestic Filing Exception

Domestic Filing Exception Test # 3

Test 1 & Test 2 must be met

Notify partner or shareholder NO K-3 will be received

Partners or Shareholders must request K-3

No IRS notification form

Domestic Filing Exception Test # 4

Requests from partner or shareholder
due 1-month before entity filing deadline

Complete relevant sections of Schedule
K-2 & K-3

Practitioner Note – Late Request

Requests – active until requesting partner or shareholder revokes

Practitioner Note – Complete Return

FIGURE 11.13
Parts of Schedules K-2 and K-3 (Form 1065)

Part	Title	Topic	Applies to S Corporations
I	Partnership's Other Current Year International Information	All other	X
II	Foreign Tax Credit Limitation	Foreign tax credit	X
III	Other Information for Preparation of Form 1116 or 1118	Foreign tax credit	X
IV	Information on Partners' Section 250 Deduction With Respect to Foreign-Derived Intangible Income (FDII)	FDII	
V	Distributions from Foreign Corporations to Partnership	Previously-taxed earnings and profits	X
VI	Information on Partner's Section 951 (a)(1) and Section 951A Inclusions	Subpart F/global intangible low-taxed income (GILTI)	X
VII	Information to Complete Form 8621	Passive foreign investment company	X
VIII	Partnership's Interest in Foreign Corporation Income (Section 960)	Deemed foreign tax credit	X
IX	Partners' Information for Base Erosion and Anti-Abuse Tax (Section 59A)	Base erosion and anti-abuse tax	
X	Foreign Partners' Character and Source of Income and Deductions	Effectively connected income and fixed, determinable, annual, or periodical income	
XI	Section 871(m) Covered Partnerships	Publicly traded partnerships	
XII	Reserved for Future Use	N/A	
XIII	Foreign Partner's Distributive Share of Deemed Sale Items on Transfer of a Partnership Interest	1040-NR and 1120-F	

FIGURE 11.14
Filing Requirements

Part	Filing Requirements
I	General information as needed
II and III	Partner's status: Direct or indirect partner eligible for a foreign tax credit (individuals, corporations, trusts and estates)
IV	Partner's status: Direct or indirect domestic C corporation partner
V	Partnership's activities: Directly or indirectly received distributions from previously-taxed earnings and profits of foreign corporations (i.e., files Form 5471, Schedule P)
VI	Partnership's activities: Directly or indirectly owns a controlled foreign corporation
VII	Partnership's activities: Directly or indirectly owns a passive foreign investment company
VIII	Partner's status: Direct or indirect domestic C corporation partner or partner eligible to make a Section 962 election Partnership's activities: Directly or indirectly owns a controlled foreign corporation
IX	Partner's status: Direct or indirect large domestic C corporation partner (average annual gross receipts \$500,000,000 or more)
X	Partner's status: Direct or indirect foreign partner
XI	Partnership's activities: Partnership is a publicly traded partnership
XIII	Partner's status: Direct or indirect foreign partner that sold or transferred a partnership interest, in whole or in part



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- Practitioner Note – Partner’s Status
 - W-9
 - W-8BEN
- Penalties
 - Failure to File
 - \$235 per partner/shareholder per month
 - Failure to Report
 - Reasonable cause relief
- Practitioner Note – Transition Period Relief

► Schedules K-2 & K-3 deal with reporting _____ tax items:

► Farming

► Timber

► Foreign

Polling Question # 4



Questions?

