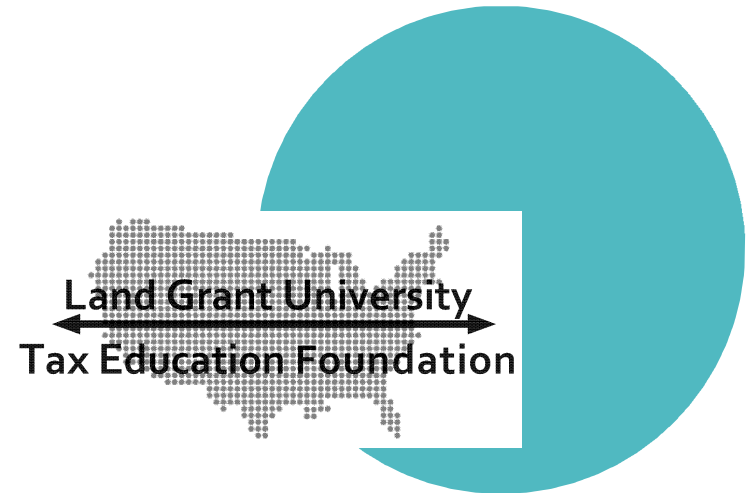


# 2021 National Income Tax Workbook

## CHAPTER 5: CHOICE OF ENTITY





## Learning objectives P. 201

- ✓ Issue 1 – Entity Classification
- ✓ Issue 2 – Entity Types
- ✓ Issue 3 – Losses Limited by Basis
- ✓ Issue 4 – Self-Employment Tax
- ✓ Issue 5 – Qualified Business Income
- ✓ Issue 6 – Fringe Benefits
- ✓ Issue 7 – Income Tax Filing Obligations
- ✓ Issue 8 – Multiple Entity Issues

# Introduction

## P. 201

TCJA of 2017 --- Corp Tax  
Rate 21% flat

No QBI on C Corp  
distributions

S Corp, Partnership & LLC's –  
NO Entity level tax

S Corp Shareholders – NO SE  
Tax



# Issue 1: entity classification





Default Entity  
classification  
P. 202

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I.R.C. 7701(a)(2): Partnership

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I.R.C. 7701(a)(3): Corporation

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Treas. Reg. 301.7701-3: Unincorporated,  
Multiple Owner = Partnership

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Treas. Reg. 301.7701-3(b)(1): Elect  
Corporate Status

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I.R.C. 1361(a): C Corp unless S election  
is made

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Single-Member LLC: Disregarded Entity

**FIGURE 5.1**  
**Classification of Domestic Business Entities**

State Law	Federal Tax Default	Federal Tax Elections*
Sole proprietorship	Income reported by owner	None
Commercial corporation	C corporation	S corporation
Professional corporation	C corporation	S corporation
General partnership	Partnership	C corporation or S corporation
Limited partnership	Partnership	C corporation or S corporation
Limited liability partnership	Partnership	C corporation or S corporation
Limited liability limited partnership	Partnership	C corporation or S corporation
SMLLC	Disregarded entity	C corporation or S corporation
LLC—multimember	Partnership	C corporation or S corporation

\*Treas. Reg. § 301.7701-3

Figure 5.1 –  
 Classification  
 of Domestic  
 Business  
 Entities  
 P. 202



LLC  
Classification  
Changes  
P. 203

Form 8832 (Entity  
Classification Election) –  
Electing C Corp status

Form 2553 (Election by a  
Small Business Corporation)  
– Electing S Corp status




# LLC to Corporation P. 203

- LLC Owner Contribution of Assets & Liabilities = Corporate Stock
- I.R.C. 351 – no gain or loss recognized
  - Immediately after exchange = Control of Corp
- Practitioner Note – Limit on election
  - 60-month limitation
  - 50% Ownership change

# LLC Ownership changes P. 203

- SMLLC to MMLLC = Partnership
- MMLLC to SMLLC = Disregarded Entity
- Cross-Reference
  - Spousal LLC
  - SMLLC
  - 2019 Tax Workbook

# SMLLC to MMLLC P. 203

- 
1. Sale of an interest
  2. Gift of an interest
  3. Death of a member & distribution of the member's interest to multiple heirs
  4. Divorce of spouse (Rev. Proc. 2002-69, 2002-2 C.B. 831)
  5. Relocation of spouses reporting (Rev. Proc. 2002-69)
  6. Distribution of an interest from an entity to multiple shareholders, partners, members or beneficiaries



# MMLLC to SMLLC P. 204

1. Sale of all LLC interests
2. Gift of all LLC interests
3. Redemption of LLC interests
4. Death of a member
5. Relocation of spouses to a community property state
6. Divorce award of an interest to one spouse in non-community property state
7. Merger of members of an LLC
8. Purchase of the interests of all but one owner under I.R.C. 736 retirement of a partner provision

# Corporation Classification changes P. 204

- Form 2553
- § 1362 – Revocation of S Election
- Cross-Reference: S Corp Eligibility
  - I.R.C. 1361 & 1362
  - Domestic Corp
  - 100 Shareholder limit (with attribution)
  - One class of stock
  - Not an ineligible entity

# Polling Question #1

An LLC could be taxed as a Disregarded Entity or Partnership depending upon the number of members.

True or False





# Issue 2: entity types



## Issue 2: Entity Types P 205

- Liability Protection
- Step-Up Basis
- Sale of Owner's Interest
- Allowable type & number of owners
- Partnership Audit Regime

# Practitioner Note – Other Factors P. 205

- Liability Protection
- Step-Up Basis
- Sale of Owner's Interest
- Allowable type & number of owners
- Partnership Audit Regime

# Single Member LLC (SMLLC) P. 205

- Disregarded Entity
- Assets, Liabilities, income & deductions belong to owner
- Schedule C, E, F
- Subject to SE Tax
- §199A (QBI) Eligible
- Practitioner Note – practicing law
- Practitioner Note – EIN
  - For Employment Taxes
  - For Excise Tax
  - State Sales/Use Tax



# Partnerships

## PP. 205-206

- MMLLC
- Economic Relationship
- I.R.C. 761(a) – reporting & filing requirements
- Includes:
  - Syndicate group
  - Pool
  - Joint venture
  - Not otherwise classified as corporation, trust or estate

# Partnerships

## PP. 206

- Partner – member in syndicate, group, pool, joint venture or organization
- Partnership –
  - Common-law
  - Broader scope
  - Doesn't have to organize at the State Level
- Cross-Reference – Electing out of Subchapter K
  - Treas. Reg. 1.761-2
  - Qualified Joint Venture – married members & file MFJ
  - 2017 Tax Workbook

# Partnerships

## PP. 206

- Pass Through to Partners/Member
  - Income
  - Gain/Loss
  - Deductions
  - Credits
  - Taxed on Distributive Share
  - SE Tax
- I.R.C. 704(b) – allocation of interest
- I.R.C. 704(c) – required to allocated built-in gains/losses
- Treas. Reg. 69-184, 1969-1 C.B. 256 – Partners DO NOT receive wages
- Partners receive Guaranteed Payments

# C Corporations P. 206

- 21% Flat Tax
- Qualified Dividends taxed at shareholder level
  - 0%, 15%, 20%
  - 3.8% NIIT (Net Investment Tax)
- Cross-Reference: C Corp vs. Pass-through
  - Lower tax rate
  - Retained Earnings < Partnership or S Corp
  - Corp tax rate > shareholder or partners personal tax rate



# S Corporation

## P. 207

Mason Manufacturing

- I.R.C. 1363(a) – S Corp Pays no tax on earnings
- Pass Through items – income, loss, deduction, credits
- Reasonable Compensation to Shareholders
  - Service providers
  - No SE Tax
  - Receive W-2
- Built-In Capital Gains (BIG) – if C Corp first

# Figure 5.2

P. 208

**FIGURE 5.2**  
**Comparison of Business Entities**

Item	Partnerships	S Corporations	C Corporations	Disregarded Entity
Entity classification	Default status for multimember LLC	Elective status for multimember LLC or SMLLC if qualified for S corporation status and filing Form 2553	Elective status for multimember LLC or SMLLC filing Form 8832	Default status for SMLLC
Maximum number of equity interests	No maximum number	Maximum 100 shareholders (family members may be treated as one shareholder for this purpose)	No limitation	One
Classes of equity interests	No limitation	One class of stock (voting rights are disregarded in making this determination)	No limitation	N/A
Ineligible entities	Generally, partnerships with equity interests that are publicly traded; banks and certain insurance companies must use the corporate form	Foreign corporations; financial institutions using reserve method of accounting; insurance companies; domestic international sales corporations (DISCs) and former DISCs	None	N/A
Eligible owners	All persons and entities eligible to be partners	Individuals, estates, certain trusts, charities, and qualified retirement plans	All persons eligible	Individual
Foreign taxpayers	Eligible to be a partner; certain income subject to withholding tax	Ineligible to be a shareholder	Eligible to be a shareholder; dividends subject to withholding tax with possible reduced treaty rate	Eligible
Tax-exempt taxpayers	Eligible to be a partner; income subject to generally applicable unrelated business income tax	Tax-exempt taxpayers (other than charities and qualified retirement plans) ineligible to be a shareholder; all items of income and loss of charities and qualified retirement plans (other than ESOPs) included in unrelated business taxable income; items of income and loss of ESOPs not included in unrelated business taxable income	Eligible to be a shareholder; dividend generally not subject to unrelated business income tax	Eligible to be an owner; income subject to generally applicable unrelated business income tax
Trusts	Eligible to be a partner; usual trust taxation rules apply	Only grantor trusts, testamentary trusts, qualified subchapter S trusts, and electing small business trusts eligible as shareholders; special taxation rules apply	Eligible to be a shareholder; usual trust taxation rules apply	Eligible

# Figure 5.2

P. 209

**FIGURE 5.2 (continued)**  
**Comparison of Business Entities**

Item	Partnerships	S Corporations	C Corporations	Disregarded Entity
Allocation of income and losses	Allocation in accordance with partnership agreement if allocation is in accordance with each partner's interest in the partnership, or the allocation has substantial economic effect	Pro rata among shares on a daily basis	Not applicable (income and losses do not pass through)	All to owner
Limitation on losses	Losses limited to basis in partnership interest, which includes partner's share of partnership debt; subject to amount at risk, passive activity loss, and excess business loss limits	Losses limited to basis in stock and indebtedness of corporation to shareholder; no inclusion of corporate debt in shareholder basis; subject to amount at risk, passive activity loss, and excess business loss limits	Losses deductible against corporate income; NOLs generally can be carried forward; capital losses generally can be carried back 3 years and forward 5 years	Subject to amount at risk, passive activity loss, and excess business loss limits
Contributions of unencumbered property to entity	Tax-free; built-in gain or loss allocated to contributing partner	Tax-free if contributors are in control of the corporation after the exchange; no special rules allocating built-in gain or loss to contributor	Tax-free if contributors are in control of the corporation after the exchange	N/A
Distributions of property (liquidating or otherwise)	Generally tax-free; carryover or substituted basis to partner; partnership may elect to make basis adjustment in partnership property to reflect adjustments to distributee partner	Any gain in distributed property is recognized by the corporation and allocated to the shareholders; FMV basis to the shareholder	Any gain in distributed property taxable to the corporation; shareholder taxed if amount of distribution exceeds stock basis	All business property treated as property of owner
Transfer of equity interests	Gain treated as ordinary income to extent of ordinary income on assets held by partnership; partnership may elect to adjust basis of its assets with respect to transferee partner to reflect purchase price	Gain treated as capital; no adjustments to basis of corporate property	Gain treated as capital	Fully taxable as asset sale, unless contributed to partnership or controlled corporation
Termination of entity	Termination if not more than one owner, or ceases to carry on any business or investment	No provision	No provision	Generally, nontaxable

# Figure 5.2

P. 210

**FIGURE 5.2 (continued)**  
**Comparison of Business Entities**

Item	Partnerships	S Corporations	C Corporations	Disregarded Entity
Treatment of C corporation converting to partnership or S corporation	Corporation must liquidate and gain or loss is recognized to corporation and shareholders	Generally, no taxation upon election; corporate tax is imposed on built-in gain if assets sold during 5-year period after election effective; distribution of subchapter C earnings and profits taxable as a dividend; special rules applicable to a corporation with accumulated earnings and excess net passive investment income	N/A	N/A
Treatment of disregarded entity or partnership converting to C corporation or S corporation	Tax-free if transferors are in control of the corporation after the exchange; possible exception where contributed property is subject to debt	N/A	N/A	Tax-free if transferor is in control of the corporation after the exchange; possible exception where contributed property is subject to debt
Mergers and other reorganizations with corporations	Not eligible to engage in tax-free reorganization with corporation	Eligible party to a tax-free corporate reorganization	Eligible party to a tax-free corporate reorganization	Not eligible to engage in tax-free reorganization with corporation
Corporate tax rules of subchapter C	Rules inapplicable	Rules generally applicable, with certain exceptions	Rules applicable	Rules inapplicable
Wholly owned corporate subsidiary	Corporation treated as separate entity	Parent corporation may elect to treat wholly owned subsidiary as disregarded entity	Not subject to tax on dividends or liquidating distributions paid between wholly owned subsidiaries; may be eligible to file consolidated returns	Corporation treated as separate entity
Federal income tax rates	All income is allocated to owners and taxed at their rates	All income that exceeds reasonable compensation to owner employees is allocated to owners and taxed at their rates	All income that exceeds reasonable compensation to owner employees is taxed at a flat 21% rate	All income is taxed to the individual owner
Application of employment and SE taxes	Except in certain cases involving a limited partner, each partner's share of net business income is net earnings from SE	Amounts paid as reasonable compensation to a shareholder-employee are wages subject to employment tax; no amount of shareholder's share of S corporation income is net earnings from SE	Amounts paid as compensation are wages subject to employment tax; no amounts are net earnings from SE	Net business income is net earnings from SE



# Figure 5.2

P. 211

FIGURE 5.2 (continued)  
Comparison of Business Entities

Item	Partnerships	S Corporations	C Corporations	Disregarded Entity
Treatment of earnings as investment income for purposes of the net investment income tax (NIIT)	Business income of limited partners who are not active in the business and that is not net earnings from SE is treated as investment income for the NIIT	Business income of shareholders not active in the business is treated as investment income for the NIIT	Dividends paid to individuals are treated as investment income for the NIIT	Subject to NIIT unless section 1231 gain or income subject to SE tax
Qualified business income (QBI)	QBI, W-2 wages, and qualified property passed through to eligible partners	QBI, W-2 wages, and qualified property passed through to shareholders	Not eligible for QBI deduction	QBI, W-2 wages, and qualified property used to calculate the owner's QBI deduction

## Polling Question #2

When considering the choice of entity non-tax considerations, like liability protection, are important.

True or False



Issue 3:  
Losses  
Limited by  
Basis



# Partnership losses P. 212

- Outside Basis = Member's Interest
- Inside Basis = Asset Basis of the Partnership/LLC
- Loss limitation = Outside Basis
  - I.R.C. 704(d)
  - Losses up to Adjusted Basis
  - Carry Over of unused losses



# Calculating basis (§705) P. 212

- Increase by
  - Additional contributions
  - Partner's share of partnership liabilities
  - The partner's distributive share of taxable & nontaxable partnership income
- Decrease by
  - Adjusted basis of distributions
  - Losses
  - Nondeductible expenses (not capital expenditures)

I.R.C. 752(a)  
& I.R.C.  
721(a)  
P. 212

- Reallocation of Partnership Liabilities
  - Increase = cash contributions
- Practitioner Note: COVID RELIEF LOANS AND/OR GRANTS
- PPP Forgiven amounts = Tax Exempt Income
- EIDL Advance = Tax Exempt Income
- RRG = Tax Exempt Income
- State/Local Grants = Tax Exempt Income
- Increase Basis

# S Corporation Losses P. 212

- Basis at the Shareholder Level ONLY
- I.R.C. 1366(d)(1)
  - Losses > stock basis + loan basis =  
DISALLOWED
- Stock Basis @ time of acquisition
  - Increase
    - Income
  - Decrease
    - Deductions
    - Losses
    - Distributions

# Adjustments to Basis & Ordering rules P. 213

- Annual Event
- Immediately before Disposition
- Ordering Rules
  - Income items – income, tax-exempt, separately stated, excess depletion = increase
  - Distributions (NOT C Corp AE&P) = decrease (not below zero)
  - Non-deductible, non-capital expense, depletion = decrease (not below zero)
  - Loss & deduction = decrease (not below zero)
- Cross-Reference
  - Treas. Reg. 1.1367-1(g)

# Example 5.1

– Losses  
Greater  
than Basis  
P. 213

S Corporation

One Shareholder

Stock Basis = \$ 30,000

\$ 40,000 Loss

Loss Limitation = 30,000

Carry Over Loss = \$ 10,000



# Shareholder Loans P. 213

Treas. Reg. 1.1366-2 –  
Bona fide  
indebtedness

Guaranteeing Loan –  
NOT bona fide  
indebtedness

Treas. Reg. 1.1366-  
2(a)(2)(ii) –  
shareholder payment  
of corporate debt

- Increase loan debt

## Example 5.2 – Shareholder Guarantee P. 213

Sole Shareholder, Claire

Guaranteed \$ 100,000 bank loan to Glacier

Claire paid \$ 20,000 (principle) to bank for loan to Glacier

Claire INCREASES loan basis by  
\$ 20,000

Treas. Reg. 1.1366-2(a)(2)(iii), Example 4

# Practitioner Note – Draft Form 7203 P. 213

<b>7203</b> Form 7203 (December 2021) Department of the Treasury Internal Revenue Service		<b>S Corporation Shareholder Stock and Debt Basis Limitations</b> Attach to your tax return. Go to <a href="http://www.irs.gov/Form7203">www.irs.gov/Form7203</a> for instructions and the latest information.		OMB No. 1545-XXXX Attachment Sequence No. <b>203</b>			
Name(s) shown on return			Identifying number				
Name of S corporation			Employer identification number				
Stock block (see instructions) ▶							
<b>Part I Shareholder Stock Basis</b>							
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) <b>Note:</b> 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				
<b>Part II Shareholder Debt Basis</b>							
<b>Section A—Amount of Debt (If more than three debts, see instructions.)</b>							
Description	Debt 1		Debt 2		Debt 3		Total
	<input type="checkbox"/> Formal note <input type="checkbox"/> Open account debt		<input type="checkbox"/> Formal note <input type="checkbox"/> Open account debt		<input type="checkbox"/> Formal note <input type="checkbox"/> Open account debt		
16 Loan balance at the beginning of the corporation's tax year							
17 Additional loans (see instructions)							
18 Loan balance before repayment. Combine 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. Combine lines 18 and 19							
For Paperwork Reduction Act Notice, see separate instructions.							
Cat. No. 56398V Form <b>7203</b> (12-2021)							

# Practitioner Note – Draft Form 7203 P. 213

**Part II Shareholder Debt Basis** *(continued)*

**Section B—Adjustments to Debt Basis**

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

**Section C—Gain on Loan Repayment**

<b>32</b> Repayment. Enter the amount from line 19				
<b>33</b> Nontaxable repayments. Enter the amount from line 26				
<b>34 Reportable gain.</b> 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
<b>35</b> Ordinary business loss					
<b>36</b> Net rental real estate loss					
<b>37</b> Other net rental loss					
<b>38</b> Net capital loss					
<b>39</b> Net section 1231 loss					
<b>40</b> Other loss					
<b>41</b> Section 179 deductions					
<b>42</b> Charitable contributions					
<b>43</b> Investment interest expense					
<b>44</b> Section 59(e)(2) expenditures					
<b>45</b> Other deductions					
<b>46</b> Foreign taxes paid or accrued					
<b>47 Total loss.</b> Combine 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					

# Self- Employment Tax P. 214

SMLLC & General Partners

Some MMLLC members

Disguised Distributions

- Avoid SE Tax
- Avoid Payroll Taxes

Example: \$ 10,000 SE Income

- 34.6% tax rate
- 22% marginal tax rate
- QBI Deduction

## Polling Question #3

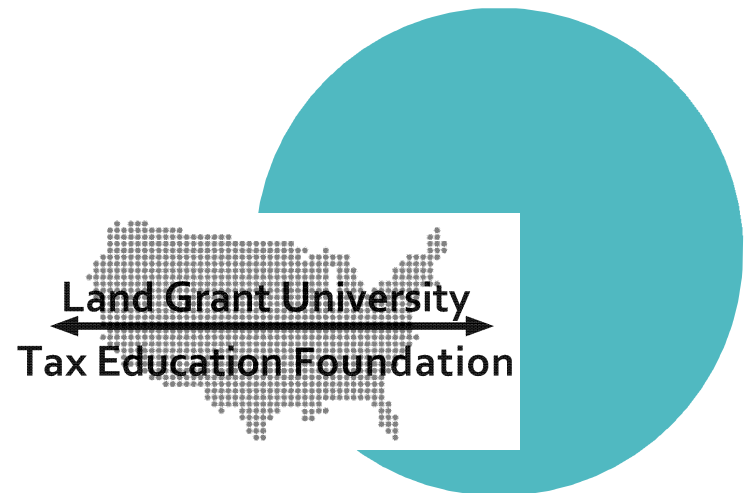
Losses limited by Basis are unimportant and have no relevance to taxes.

True or False





# Issue 5: Qualified Business income deduction



# QBI Defined

## P. 215

- Choice of Entity – increase or decrease QBI
- C Corp – NO QBI
- Sole Proprietor, SMLLC, Partnership or S Corp
- DOES NOT INCLUDE – wages, salaries or guaranteed payments for services
- Taxable Income Thresholds:
  - \$ 164,900 S & HOH
  - \$ 329,800 MFJ
  - \$ 164,925 MFS

# QBI Defined

## P. 215

- S Corp Shareholder Salary
  - Reasonable Compensation
  - Includes distributions
- IRS Reclassify Distributions to Compensation

# Guaranteed Payments

## P. 216

- Reduce QBI
- Higher pass-through/distributive share of income = Higher QBI
- Example 5.3
- J&J Construction Partnership
- \$ 550,000 income
- \$ 250,000 guaranteed payments
- \$ 300,000 pass through income
- Partners share of QBI = \$ 150,000

# Profit Allocation Example 5.4

## P. 216

J&J Construction Partnership



No Guaranteed Payment

\$ 550,000 income

Partners share of QBI =  
\$ 275,000

# Issue 6: Fringe Benefits

P 217





I.R.C.  
3401(a),  
Treas. Reg.  
31.3101(a),  
& I.R.C. 1372

P. 217

- Fringe benefits – included in income
  - unless specifically excluded 😊
- 2% Shareholder of S Corporation
  - treat as General Partner
  - treat as Self-Employed
  - Practitioner Note – attribution rules

# Tax treatment of Health & Accident Insurance

Pp. 217-218

- S Corp 2% Shareholder
  - Corp deducts premium payment
  - No reduction in distributions
- Partnership
  - Treated as guaranteed payment
  - Reduction of distributions
- SE Health Insurance Deduction
  - 2% shareholder – if included in Wages
  - Limited to Earned Income

# Tax treatment HSA

P. 218

- Contributions – adjustments to AGI
- NOT included in gross income
- High-deductible health plan participant
  - \$ 1,400 self-only coverage
  - \$ 2,800 family coverage
- Out-of-pocket expenses limitation
  - \$ 7,000 self-only
  - \$ 14,000 family
- Contribution Limits
  - \$ 3,600 self-only
  - \$ 7,200 family

# Tax treatment of HSA

PP. 218 -219

- S Corp 2% Shareholder
  - cannot exceed gross income
  - not subject to FICA or FUTA
- Partnership
  - Not contributions by employer
  - Contributions = Distributions to partner
  - Report on K-1 as Distribution
  - Deduct on Partner's return

# Tax Treatment of Group Term Life

P. 219

- \$ 50,000 excluded from wages
- Excess of \$ 50,000 included in wages
- 2% shareholder or partner = NO exclusion
- 2% shareholder
  - Included in wages
  - Subject to FICA only

# Tax Treatment of Meals & Lodging

P. 219

- Excluded from gross income
- Meals served on premises
- Lodging –
  - On employer's premises
  - Condition of employment



# Tax Treatment of Cafeteria Plans

P. 219

- Not available to –
  - Self-Employed
  - 2% Shareholders
  - Partners
- Planning Pointer –
  - 2% shareholder may disqualify the plan
  - Consider before converting C to S Corp

# Tax Treatment of Educational Assistance

P. 220

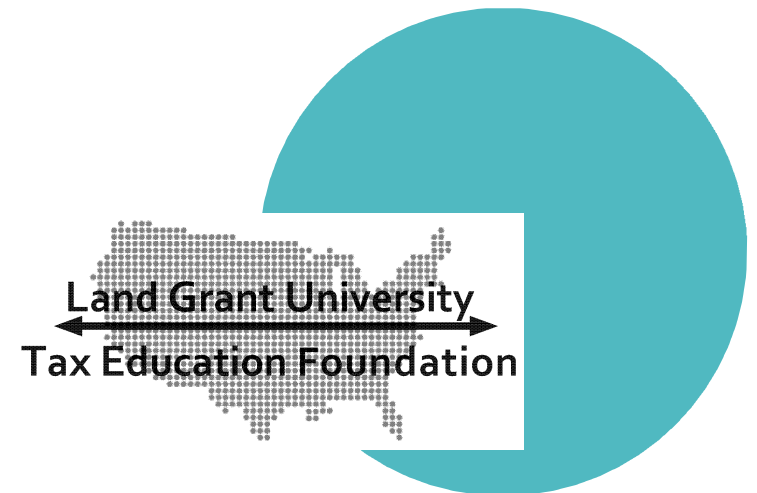
- Non-taxable fringe benefit
- 5% S Corp Shareholder
  - Compensation < \$ 130,000
  - Not Highly compensated employee
- Practitioner Note – student loan interest payments
  - March 27, 2020 thru December 31, 2025

# Tax Treatment of Dependent Care Assistance

P. 220

- Maximum Exclusion
  - \$ 10,500 per year
  - \$ 5,250 MJS
- 5% S Corp Shareholders

# Issue 7: Income Tax Filing Obligations

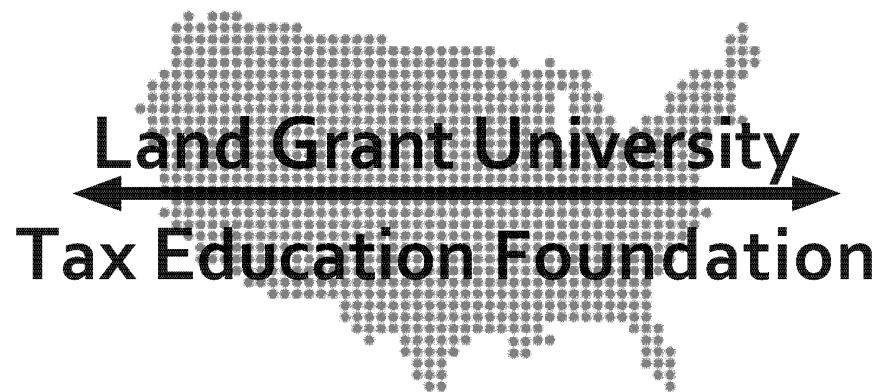


# Filing Requirements

## PP 221 - 222

- SMLLC or Disregarded Entity – 15<sup>th</sup> Day of 4<sup>th</sup> month following close of tax/fiscal year end
- Partnership -- 15<sup>th</sup> Day of 3<sup>rd</sup> month following close of tax/fiscal year end
- C Corporation – 15<sup>th</sup> Day of 4<sup>th</sup> month following close of tax/fiscal year end
- S Corp – 15<sup>th</sup> Day of 3<sup>rd</sup> month following close of tax/fiscal year end
  - Reverting back to C Corp – S Corp has short year return by C Corp Due Date
- Extensions available to all the above





# Issue 8: Multiple Entity issues



# Controlled Groups

## P. 223

- I.R.C. 1563 – two or more entities
  - common ownership
  - benefit plans – all employees of all entities
- Practitioner Note – Other Aggregations
  - Certain Credits
  - Cafeteria Plans
- §179 Depreciation
- Types of Controlled Groups
  - Parent – Subsidiary
  - Brother - Sister



# Parent – Subsidiary

## P. 223

- One or More “chains” – connected through stock ownership
- Parent Tests – common parent
  - 80% of the total combined voting power of all classes of stock OR
  - at least 80% of the total value of shares of all classes of stock of each of the corporations, EXCEPT
  - the common parent corporation, is owned by one or more of the other corporations
- 80% of the total combined voting power of all classes of stock entitled to vote OR
  - at least 80% of the total value of shares of all classes of stock of at least one of the other corporations, EXCLUDING
  - voting power or value, stock owned directly by such other corporation.

## Brother – Sister

P. 223

5 or fewer “persons” – individuals, estates/trusts

Own two or more entities

Total combined voting power > 50%

Directly owned stock

Constructive ownership

# Constructive ownership

## P. 224

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Stock options owned by a person are treated as stock owned by such person.

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Directly or indirectly 5% or more capital or profits interest in the partnership.

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Directly or indirectly by an estate or trust [other than an I.R.C. §401(a) employees' trust] is deemed owned by any beneficiary who has a 5% or more actuarial interest, to the extent of the actuarial interest.

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Stock owned directly or indirectly by a trust (other than an employee's trust) in which a person is considered the owner (grantors and others treated as substantial owners) is deemed owned by such owner.

# Constructive ownership

## P. 224

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Stock owned directly or indirectly by a corporation is deemed proportionately owned by any shareholder who owns 5% or more in value of its stock.

---

Stock owned directly or indirectly by a spouse (other than a spouse who is legally separated from the individual under a decree of divorce or decree of separate maintenance) is deemed owned by the individual, unless all of the following criteria are met:

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The individual does not directly own any stock in the corporation during the year.

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The individual is not a director or employee and does not participate in the management of the corporation during the year.

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Not more than 50% of the corporation's gross income for the tax year is derived from royalties, rents, dividends, interest, and annuities.

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The stock is not subject to conditions that limit the spouse's right to dispose of the stock and run in favor of the individual or the individual's children who have not attained age 21.

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# Constructive ownership

## P. 224

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Stock owned directly or indirectly by an individual's children under the age of 21 is deemed owned by the individual.

---

Stock owned directly or indirectly by an individual is deemed owned by the individual's children under the age of 21.

---

An individual who owns more than 50% of the total combined voting power or total value of a corporation's stock is deemed to own the stock held directly or indirectly by his or her parents, grand parents, grandchildren, and children who have attained age 21.

# Practitioner Note & Cross Reference 224

P.

## Practitioner Note – Affiliated Service Group

All employees of all members

Considered employee of single employer



## Cross-Reference – QBI Aggregation

Multiple trade/business

No SSTB



# Applicable Large Employers

P. 225

Minimum Essential Coverage (MEC)

Affordable & Minimum Value (MV)

Full-time employees

Employer Shared Responsibility Payment (ESRP)

Premium Tax Credit (PTC) available to employee if:

- Did not offer MEC to at least 95% of full-time employees, or
- Offered coverage that was not affordable or that did not provide MV or did not offer such coverage to the full-time employee receiving the PTC.



## Aggregating Employees

- Controlled Groups
- Common Control
- Full-time employees 50 or more (prior year) = ALE
- Each employer of group
  - Responsible for their own ESRP
  - Cross-Reference – Common Control

## Polling Question #4

S Corporation Shareholders  
may be limited with Fringe  
Benefits.

True or False



Questions?