

# S Corporations: Review and Update




## S Corporations: Review and Update

Materials developed and presented by:  
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1

## Introduction



**Doug Van Der Aa** is a lively and energetic speaker – especially on the subject of taxes and ethics. He has been a highly rated speaker and seminar leader for CPA Associations and other organizations throughout the country for more than 18 years.

Doug has over 25 years of professional experience, including tax practice in CPA firms and the practice of transactional business and real estate law as an attorney. As a CPA, Doug’s practice concentrated on the tax needs of closely held businesses, with their related pass-through entities, complex individual returns, estates and trusts.

Doug Van Der Aa, CPA, JD

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2

# S Corporations: Review and Update



## Course Development Resources

- The author gratefully acknowledges **RIA Checkpoint** for use of certain materials included in this presentation.
- Additional materials are adapted from various authoritative pronouncements of the IRS.
- The opinions expressed within, however, are solely the responsibility of the author.

3

## Learning Objectives



- Apply the latest tax rules and regulations of S Corporations.
- Understand the new IRS requirement to report Shareholders' tax basis.
- And the New K-2 & 3 Filing Exception
- Discuss planning and potential pitfalls.

4

# S Corporations: Review and Update

## One Class of Stock



5

## Advantages of S Corporations

- Limited Liability
- No Double Taxation (Generally)
- Passthrough of Losses and Credits



6

# S Corporations: Review and Update

## Advantages of S Corporations

Passthrough and Distributions Are  
**Not Subject to Self-Employment Tax!**



7

## COVID-Related Tax Relief Act of 2020

### *Business relief included:*

- PPP2 Loan Program
- Clarification of PPP Loan Forgiveness
- Employee Retention Credit changes
- 100% business meal deduction



8

# S Corporations: Review and Update

## Paycheck Protection Program

### PPP Loan Forgiveness

- A portion of the loan may be forgiven - **Tax-Free!**
- But the IRS had said that the business expenses were **non-deductible!**



9

## COVID-Related Tax Relief Act of 2020

*The Act expressly overrides the IRS position and provides that:*

**“no deduction shall be denied, no tax attribute shall be reduced, and no basis increase shall be denied, by reason of the exclusion from gross income provided...”**

*(Section 276)*



10

# S Corporations: Review and Update

## COVID-Related Tax Relief Act of 2020

***The Act expressly overrides the IRS***

The IRS promptly surrendered and issued Revenue Ruling 2021-02 on January 6, which “obsoletes” Notice 2020-32 and Rev. Ruling 2020-27



11

## S Corporation and Partnership PPP Forgiveness Basis

Under Code Section 276 S-Corporations and Partnerships treat the exclusion from gross income as tax-exempt income.

- *And increase their basis*



12

# S Corporations: Review and Update

## S Corporation and Partnership PPP Forgiveness Basis

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### ***But when do you get the increase in basis?***

- When the PPP Loan is forgiven?
  - Cash Basis or All Events Test....
- Or,
- When the qualifying expenses are paid or incurred?

13

## S Corporation and Partnership PPP Forgiveness Basis

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### ***The AICPA asked the IRS for guidance on three issues:***

- Recommending the basis adjustment occurs when the expenses are paid
- Recommending that the IRS issue guidance to the treatment in the S Corp OAA account
- Asking for clear guidance on how to report on the 1120-S and 1065



14

# S Corporations: Review and Update

## S Corporation and Partnership PPP Forgiveness Basis

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On November 18, 2021 the IRS addressed the first of these questions, issuing three Revenue Procedures on the treatment of amounts excluded from gross income in connection with forgiveness of PPP loans.



15

## S Corporation and Partnership PPP Forgiveness Basis

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**Revenue Procedure 2021-48** provides that taxpayers may treat amounts that are excluded from gross income (tax-exempt income) in connection with the forgiveness of Paycheck Protection Program (PPP) Loans as received or accrued:

- 1) As eligible expenses are paid or incurred,
- 2) When an application for PPP Loan forgiveness is filed, or
- 3) When PPP Loan forgiveness is granted.

16



# S Corporations: Review and Update

## S Corporation PPP Forgiveness



*An S corporation should include tax-exempt income from the forgiveness of PPP loans on line 3 and report expenses paid with PPP loans that are forgiven on line 5 in column (d) of the Schedule M-2.*

17

## S Corporation PPP Forgiveness



*in column (d) on line 3 of the Schedule M-2.*

*An S corporation should report expenses paid this year with proceeds from PPP loans that were forgiven this year in column (d) on line 5 of the Schedule M-2.*

*If column (a) on line 2 or line 4 of the Schedule M-2 includes expenses paid with proceeds from forgiven PPP loans, an S corporation should report that amount in column (a) on line 3 and in column (d) on line 5 of the Schedule M-2.*

*If column (a) on line 1 of the Schedule M-2 includes expenses that were paid in a prior year with proceeds from PPP loans that were forgiven this year, an S corporation should report that amount in column (a) on line 3 and in column (d) on line 5 of the Schedule M-2.*

18

## Employee Retention Credit

In **Notice 2021-49** IRS applied the related party rules to hold that if the majority owner of a business has any living relatives (other than a spouse) then the owner's wages are **NOT** eligible for the ERC!



19

## Employee Retention Credit

***Only in the rare situation when the majority owner does not have any living relatives can you use the owner's wages for claiming the ERC***



20

# S Corporations: Review and Update

## Employee Retention Credit

In light of **Notice 2021-49** you should *consider* amending previously filed ERC claims if you included the majority owner's compensation in the calculation!



21

## Employee Retention Credit

FYI – the ERC statute of limitations is open for **5 years!**  
*(Not the usual 3)*



22

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## New Schedules K-2 and K-3

Schedule K-3 (Form 1120-S)		Shareholder's Share of Income, Deductions, Credits, etc.—International		OMB No. 1545-0123
Department of the Treasury Internal Revenue Service		For calendar year 2022, or tax year beginning / / 2022, ending / /		<b>2022</b>
See separate instructions.				
Information About the Corporation			Information About the Shareholder	
A Corporation's employer identification number (EIN)			C Shareholder's identifying number	
B Corporation's name, address, city, state, and ZIP code			D Shareholder's name, address, city, state, and ZIP code	
E Check to indicate the parts of Schedule K-3 that apply.				
				Yes No
1 Does Part I apply? If "Yes," complete and attach Part I . . . . .				1 <input type="checkbox"/> <input type="checkbox"/>
2 Does Part II apply? If "Yes," complete and attach Part II . . . . .				2 <input type="checkbox"/> <input type="checkbox"/>
3 Does Part III apply? If "Yes," complete and attach Part III . . . . .				3 <input type="checkbox"/> <input type="checkbox"/>
4 Does Part IV apply? If "Yes," complete and attach Part IV . . . . .				4 <input type="checkbox"/> <input type="checkbox"/>
5 Does Part V apply? If "Yes," complete and attach Part V . . . . .				5 <input type="checkbox"/> <input type="checkbox"/>
6 Does Part VI apply? If "Yes," complete and attach Part VI . . . . .				6 <input type="checkbox"/> <input type="checkbox"/>
7 Does Part VII apply? If "Yes," complete and attach Part VII . . . . .				7 <input type="checkbox"/> <input type="checkbox"/>

23

## New Schedules K-2 and K-3

- Last summer (2021) the IRS released drafts of two new 2021 tax forms for Partnerships and S Corporations
  - Schedules K-2 and K-3
  - Replacing the good old K-1 lines 16/14
- Intended to provide pass-through owners with the information necessary to comply with the international tax provisions of the IRC

24

# S Corporations: Review and Update

## New Schedules K-2 and K-3

- Previously this information was commonly reported on pages (and pages) of confusing footnotes to the K-1
- The IRS says the new forms should standardize the reporting of this information to owners
  - *And make it easier to properly prepare their returns*

25

## New Schedules K-2 and K-3

<b>Schedule K-3</b> <b>(Form 1120-S)</b>		<b>Shareholder's Share of Income, Deductions, Credits, etc.—International</b>		OMB No. 1545-0123																								
Department of the Treasury Internal Revenue Service		For calendar year 2022, or tax year beginning / / 2022, ending / /		<b>2022</b>																								
See separate instructions.																												
<b>Information About the Corporation</b>			<b>Information About the Shareholder</b>																									
<b>A</b> Corporation's employer identification number (EIN)			<b>C</b> Shareholder's identifying number																									
<b>B</b> Corporation's name, address, city, state, and ZIP code			<b>D</b> Shareholder's name, address, city, state, and ZIP code																									
<b>E</b> Check to indicate the parts of Schedule K-3 that apply.																												
				<table border="1"> <thead> <tr> <th></th> <th>Yes</th> <th>No</th> </tr> </thead> <tbody> <tr> <td>1 Does Part I apply? If "Yes," complete and attach Part I . . . . .</td> <td><input type="checkbox"/></td> <td><input type="checkbox"/></td> </tr> <tr> <td>2 Does Part II apply? If "Yes," complete and attach Part II . . . . .</td> <td><input type="checkbox"/></td> <td><input type="checkbox"/></td> </tr> <tr> <td>3 Does Part III apply? If "Yes," complete and attach Part III . . . . .</td> <td><input type="checkbox"/></td> <td><input type="checkbox"/></td> </tr> <tr> <td>4 Does Part IV apply? If "Yes," complete and attach Part IV . . . . .</td> <td><input type="checkbox"/></td> <td><input type="checkbox"/></td> </tr> <tr> <td>5 Does Part V apply? If "Yes," complete and attach Part V . . . . .</td> <td><input type="checkbox"/></td> <td><input type="checkbox"/></td> </tr> <tr> <td>6 Does Part VI apply? If "Yes," complete and attach Part VI . . . . .</td> <td><input type="checkbox"/></td> <td><input type="checkbox"/></td> </tr> <tr> <td>7 Does Part VII apply? If "Yes," complete and attach Part VII . . . . .</td> <td><input type="checkbox"/></td> <td><input type="checkbox"/></td> </tr> </tbody> </table>		Yes	No	1 Does Part I apply? If "Yes," complete and attach Part I . . . . .	<input type="checkbox"/>	<input type="checkbox"/>	2 Does Part II apply? If "Yes," complete and attach Part II . . . . .	<input type="checkbox"/>	<input type="checkbox"/>	3 Does Part III apply? If "Yes," complete and attach Part III . . . . .	<input type="checkbox"/>	<input type="checkbox"/>	4 Does Part IV apply? If "Yes," complete and attach Part IV . . . . .	<input type="checkbox"/>	<input type="checkbox"/>	5 Does Part V apply? If "Yes," complete and attach Part V . . . . .	<input type="checkbox"/>	<input type="checkbox"/>	6 Does Part VI apply? If "Yes," complete and attach Part VI . . . . .	<input type="checkbox"/>	<input type="checkbox"/>	7 Does Part VII apply? If "Yes," complete and attach Part VII . . . . .	<input type="checkbox"/>	<input type="checkbox"/>
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26

# S Corporations: Review and Update

## New Schedules K-2 and K-3

***In general, you will be required to disclose:***

- Gross Receipts
- Deductions sorted by category
  - Sales, services, rentals, etc
- Interest expense, sorted by category
- Tax basis of assets
  - Beginning and end of year

27

## New Schedules K-2 and K-3

Practitioners ***assumed*** that these new forms would only be required where the taxpayer had foreign activities...



28

# S Corporations: Review and Update

## New Schedules K-2 and K-3

In January 2022 the IRS “clarified” that the new schedules were required of **all S Corporations** and partnerships!

- ***Unless they had “actual” knowledge that its owners didn’t need the information***

## New Schedules K-2 and K-3

In response to **severe** criticism, the IRS announced in February that it was providing additional relief for 2021 for qualifying partnerships and S Corps to entities without knowledge of owners that needed the internationally relevant information.



# S Corporations: Review and Update

## New Schedules K-2 and K-3

- When the IRS released draft 2022 K-2 & 3 Forms it appeared that the Schedules would be required for nearly all Partnerships & S Corporations...
- On October 25, the IRS seemed to bow to pressure in releasing draft instructions for the Partnership K-2 & 3 creating a **filing exception** for domestic partnerships with **solely** domestic activities and US partners.
- **On November 4, they followed up with relief for S corporations!**

31

## New Schedules K-2 and K-3

### 2022 Domestic Filing Exception

A domestic S corporation does not need to file Sch K-2 & K-3 if you satisfy **four (4) criteria**:

- 1) No or limited Foreign Activity
- 2) US Citizen/Resident Alien partners
- 3) Timely Partner Notification
- 4) No K-3 requests received

32



## New Schedules K-2 and K-3

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### 2022 Domestic Filing Exception

#### 1) No (or very limited) Foreign Activity

- Foreign Activity is defined as:
  - Foreign income taxes paid or accrued
  - Foreign source income or loss
  - Ownership interest in a foreign partnership
  - Ownership interest in a foreign corporation
  - Ownership of a foreign branch
  - Ownership of a foreign disregarded entity

## New Schedules K-2 and K-3

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### 2022 Domestic Filing Exception

#### 1) No (or very limited) Foreign Activity

- New de minimis foreign activity exception where you only have passive category foreign activity upon which not more than \$300 of foreign income taxes allowable as a credit are withheld on stocks and mutual funds

# S Corporations: Review and Update

## New Schedules K-2 and K-3

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### 2022 Domestic Filing Exception

#### 2) Timely Notification

- You must **notify** all your Shareholders that they will not be receiving a K-3 from the corporation unless they request it
  - In writing or by email
  - No later than 2 months before the due date of the return – **without extensions**

**JANUARY 15!**

35

## New Schedules K-2 and K-3

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### 2022 Domestic Filing Exception

#### 3) No K-3 requests received by the one-month date

- The corporation doesn't receive any shareholder requests for K-3 info on or before one month before the original 1120-S due date
- **February 15, 2023**
  - If you do, you must file K-2 & K-3 only for the offending shareholder(s)

36

# S Corporations: Review and Update

## New Schedules K-2 and K-3

### 2022 Domestic Filing Exception

- Note that unlike partnerships, S Corporations have no (additional) restrictions on who their shareholders may be
  - Apparently the S Corp eligible shareholder rules are strict enough !

37



## Deducting Business Losses

38

# S Corporations: Review and Update

## Limitation of Deduction of Losses

<u>Section</u>	<u>Description</u>
704(d)	Basis in Partnership interest
1366(d)	Basis in S shares and loans
465	At-risk limitation
469	Passive loss limitation
461(l)	Excess Business Losses



*These Limitations are applied successively to amounts which are deductible at all prior levels*

39

## Limitation of Deduction of Losses

**Its an obstacle course!**

Section

704(d) or 1366(d)

465

469

And finally,

461(l)

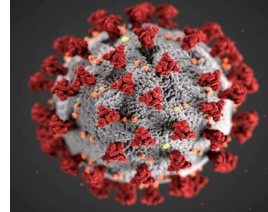


Limitations are applied successively to amounts which are deductible at all prior levels.

40

## Basis Limitation

- Tax Basis is **critically important** as people look to deduct COVID-19 losses coming thru on their K-1s.
- Partners, S Shareholders and the IRS need that information more than they have at any time in the last 10 years!



## Basis Limitation

Amount of losses that can be deducted limited to the sum of the shareholder's **basis** in S stock and direct loans or to **basis** in partnership interest (which includes your share of debt).



- Losses limited by Sections 704(d) and 1336(d) are carried over indefinitely.
- Losses carried over only with respect to that partner or shareholder.

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## Limitation of Deduction of Losses

- Losses are then limited by at-risk and passive activity rules.
- After ~~2017~~ 2020 losses are limited by section 461(l).
  - **The limit kicked in again in 2021!**



43

## Limitation of Deduction of Losses

Disallowed losses carry forward until partner/LLC member/ S Shareholder has sufficient basis, at-risk amount, or passive income to support deduction.

**Carry forward**

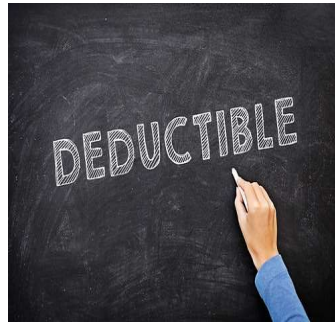
44

# S Corporations: Review and Update

## Limitation of Deduction of Losses

### *At disposition of interest:*

- 704(d) and 1366(d) are lost
- 465 are deductible
- 469 are deductible
  - *But may “crowd out” passive deductions from other sources*



45

## Shareholder Basis

### *Basis rules are **similar** to partnership rules except:*



- Partner's basis in partnership interest includes direct investment plus a ratable share of partnership liabilities.
- Except for loans from a shareholder to the S Corp, corporate borrowing does not affect shareholder's basis!

46

# S Corporations: Review and Update

## Shareholder Basis

*Determination of initial basis is similar to that of basis of stock in C corporation.*

### Depends on manner stock was acquired

- e.g., gift, inheritance, purchase, exchange



47

## Shareholder Basis

*Determination of initial basis is similar to that of basis of stock in C corporation.*

### Basis is increased by:

- Stock purchases
- Capital contributions
- Non-separately computed income
- Separately stated income items
- Depletion in excess of basis



48



# S Corporations: Review and Update

## Shareholder Basis

### *Basis is decreased by:*



- Distributions not reported as income by shareholders (e.g., from AAA or PTI).
- Nondeductible expenses (e.g., fines, penalties).
- Non-separately computed loss.
- Separately stated loss and deduction items.

## Shareholder Basis

### *Shareholder's basis **cannot be negative !***

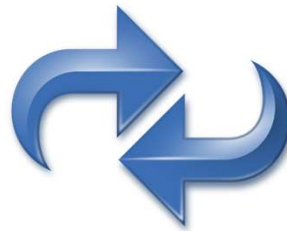


- Once basis is reduced to **zero**, any additional reductions (losses or deductions, but not distributions) decrease (but not below zero) basis in loans made to S corporation.
- Any excess losses or deductions are suspended.

## Shareholder Basis

### ***Shareholder's basis cannot be negative !***

- Once basis of debt is reduced, it is increased by subsequent net increases from all positive and negative adjustments.



## Limitation of Deduction of Losses – S Corporations

**Step 1:** Allocate total loss to the shareholder on a daily basis, based upon stock ownership

**Step 2:** If shareholder's loss exceeds stock basis, apply any excess to adjusted basis of indebtedness to the shareholder.

**Distributions do not reduce debt basis.**

**Step 3:** Where loss > debt basis, excess is suspended and carried over to future tax years.

If the shareholder's basis is insufficient to allow a full flow through and there is more than one type of loss, the flow-through amounts are determined on a pro rata basis

- *e.g., The S corp. incurs both a passive loss and a net capital loss in the same year*

# S Corporations: Review and Update

## Limitation of Deduction of Losses – S Corporations



**Step 4:** In future tax years, any net increase in basis adjustment restores debt basis first, up to its original amount.

**Step 5:** Once debt basis is restored, remaining net increase is used to increase stock basis.

**Step 6:** Suspended loss from a previous year now reduces stock basis first and debt basis second.

**Step 7:** If S election terminates, any loss carryover remaining at the end of the post-termination transition period is lost forever.

## IRS Sees Many Mistakes In Reporting S Corporation Shareholder Basis

During a June meeting of the AICPA S Corporation Taxation Technical Resource Panel, an IRS field specialist made it abundantly clear that the top three problems IRS auditors were encountering among S corporation shareholder audits were **basis, basis and basis** again. She indicated that shareholders are not properly tracking or computing the components of basis and when shareholder loans to the corporation are involved (assuming all agree as to whether such loans provide basis) and are then repaid, debt basis is not being properly accounted for.

- *AICPA Tax Section News – August 12, 2011*



# S Corporations: Review and Update

## S Corp Basis Reporting

Schedule E (Form 1040) 2020 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 disallowed loss from a passive activity (if that loss was not reported on Form 8582), or unreimbursed partnership expenses that 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 at-risk 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"/>
B					<input type="checkbox"/>	<input type="checkbox"/>
C					<input type="checkbox"/>	<input type="checkbox"/>
D					<input type="checkbox"/>	<input type="checkbox"/>

Passive Income and Loss		Nonpassive Income and Loss		
(g) Passive loss allowed (attach Form 8582 if required)	(h) Passive income from Schedule K-1	(i) Nonpassive loss allowed (see Schedule K-1)	(j) Section 179 expense deduction from Form 4562	(k) Nonpassive income from Schedule K-1
A				
B				
C				
D				

In **2018** the IRS added a new checkbox on Form 1040, Schedule E, line 28, Column (e).

55

## S Corp Basis Reporting

In **2018** the IRS added a new checkbox on Form 1040, Schedule E, line 28, Column (e).



**Apparently, quite a few taxpayers with flow-through losses were simply deducting those losses without checking whether they were limited by insufficient basis.**

56

# S Corporations: Review and Update

In 2020, the IRS added **worksheets** in the Form 1120S, Schedule K-1 instructions for calculating stock basis and basis of loans from the shareholder to the corporation.

## S Corp Basis Reporting

**Worksheet for Figuring a Shareholder's Stock and Debt Basis**

**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 (losses go on Part III) .....	3a.	_____
b. Net rental real estate income (losses go on Part III) .....	3b.	_____
c. Other net rental income (losses go on Part III) .....	3c.	_____
d. Interest income .....	3d.	_____
e. Ordinary dividends .....	3e.	_____
f. Royalties .....	3f.	_____
g. Net capital gains (losses go on Part III) .....	3g.	_____
h. Net section 1231 gain (losses go on Part III) .....	3h.	_____
i. Other income (losses go on Part III) .....	3i.	_____
j. Excess depletion adjustment .....	3j.	_____

**Part II—Shareholder Debt Basis**

	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	
<b>Amount of Debt:</b>				
1. Loan balance at the beginning of the corporation's tax year .....				
2. Additional loans (see instructions) .....				
3. Loan balance before repayment. Combine lines 1 and 2 .....				
4. Principal portion of debt repayment (this line doesn't include interest) .....	( )	( )	( )	( )
5. Loan balance at the end of the corporation's tax year. Combine lines 3 and 4 .....				
<b>Adjustments to Debt Basis:</b>				
6. Debt basis at the beginning of the corporation's tax year .....				

## S Corp Basis Reporting

### What's New

**Standard mileage rate.** The standard mileage rate for miles driven in connection with your rental activities decreased to 56 cents a mile.

**Figuring a shareholder's stock and debt basis.** See the new Form 7203 and its separate instructions, which have been developed to replace the 3-part Worksheet for Figuring a Shareholder's Stock and Debt Basis and its related instructions formerly found in the Shareholder's Instructions for Schedule K-1 (Form 1120-S).

In 2021 the IRS promoted the worksheets to a full 2 page **Form 7203** – S Corporation Shareholder Stock and Debt Basis Limitations

# S Corporations: Review and Update

## S Corp Basis Reporting

**7203** S Corporation Shareholder Stock and Debt Basis Limitations

OMB No. 1545-2302

Form 7203 (12-2021)

Department of the Treasury

Attachment Sequence No. 203

▶ Go to [www.irs.gov/Form7203](http://www.irs.gov/Form7203) for instructions and the latest information.

Name of S corporation \_\_\_\_\_ Identifying number \_\_\_\_\_

Employer identification number \_\_\_\_\_

**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)	6	
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 8849 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	
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	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	<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 (include interest)							
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. 503987 Form 7203 (12-2021)

59

## COVID-Related Tax Relief Act of 2020

The Act expressly overrides the IRS position and provides that:

“no deduction shall be denied, no tax attribute shall be reduced, and **no basis increase shall be denied**, by reason of the exclusion from gross income provided...”

(Section 276)



60

# S Corporations: Review and Update

## S Corporation and Partnership PPP Forgiveness Basis

### Don't Forget !

Under Code Section 276 S-Corporations and Partnerships treat the exclusion from gross income as tax-exempt income.

- *And increase their basis*



61

## S Corp Basis Reporting

Form <b>7203</b>		<b>S Corporation Shareholder Stock and Debt Basis Limitations</b>		OMB No. 1545-2302
(December 2021) Department of the Treasury Internal Revenue Service		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.		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>				
<b>1</b>	Stock basis at the beginning of the corporation's tax year		<b>1</b>	
<b>2</b>	Basis from any capital contributions made or additional stock acquired during the tax year		<b>2</b>	
<b>3a</b>	Ordinary business income (enter losses in Part III)	<b>3a</b>		
<b>b</b>	Net rental real estate income (enter losses in Part III)	<b>3b</b>		
<b>c</b>	Other net rental income (enter losses in Part III)	<b>3c</b>		
<b>d</b>	Interest income	<b>3d</b>		
<b>e</b>	Ordinary dividends	<b>3e</b>		
<b>f</b>	Royalties	<b>3f</b>		
<b>g</b>	Net capital gains (enter losses in Part III)	<b>3g</b>		
<b>h</b>	Net section 1231 gain (enter losses in Part III)	<b>3h</b>		
<b>i</b>	Other income (enter losses in Part III)	<b>3i</b>		
<b>j</b>	Excess depletion adjustment	<b>3j</b>		
<b>k</b>	Tax-exempt income	<b>3k</b>		
<b>l</b>	Recapture of business credits	<b>3l</b>		
<b>m</b>	Other items that increase stock basis	<b>3m</b>		
<b>4</b>	Add lines 3a through 3m		<b>4</b>	
<b>5</b>	Stock basis before distributions. Add lines 1, 2, and 4		<b>5</b>	
<b>6</b>	Distributions (excluding dividend distributions)		<b>6</b>	
<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.				
<b>7</b>	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.		<b>7</b>	



62

# S Corporations: Review and Update

## Basis of Indebtedness

- Must be direct shareholder debt
- Personal guarantees do *not* increase basis
- Stock basis is decreased by losses first, then basis in debt
- Basis in debt is restored before basis in stock



63

3-3

## Basis of Indebtedness

### **Personal guarantees do not increase basis!**

- Must be direct shareholder debt.
- New regulations require “**bona fide indebtedness**” that runs directly to the shareholder.

***Watch out for the  
“incorporated pocketbook  
theory”***



64



# S Corporations: Review and Update

## Economic Outlay

- Shareholder acquires basis in debt only if they experience an actual economic outlay.
- Issue becomes a problem with:



- Loans from related entities
- Back-to-back loans
- See AICPA Corporate Tax Insider article from June 28, 2012, by Sally Schreiber, J.D.

65

## S Corporation Open Account Debt

*I'd like to tell you a story about Mr. Brooks.....*



66

# S Corporations: Review and Update

## S Corporation Open Account Debt

### IRS Final Regs under § 1367

- Open Account Debt defined

### Open Account Debt can be netted at year end.

- BUT if balance exceeds **\$25,000** tested at year end its recharacterized as a separate debt



- **No year end netting!**
- If debt treated as a separate debt w/out basis is repaid at any time during the year, **its taxable!**

67

## S Corporation Loans Basis Planning

### Remember:

- Repayment of debt w/o basis evidenced with promissory notes, etc. = capital gains
- Repayment of Open account debt w/out basis = **Ordinary Income**



**“We miss this all the time!”**

68

# S Corporations: Review and Update

## S Corporation Open Account Debt



- **"Open account"** loans are those not evidenced by an instrument.
  - *Repayment of a reduced basis open account loan is ordinary income [Rev. Rul. 68-537, 1968-2 CB 372].*
- If a loan is evidenced by an instrument, the repayment of a reduced basis loan is capital gain (Rev. Rul. 64-162, 1964-1 CB 304 and §1271).

69

## S Corp Basis Reporting

Part II Shareholder Debt Basis				
Section A—Amount of Debt (If more than three debts, see instructions.)				
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. 56396V Form 7203 (12-2021)

70

# S Corporations: Review and Update

## S Corp Basis Reporting

Form 7203 (12-2021)		Page 2			
Part II Shareholder Debt Basis (continued)					
Section B—Adjustments to Debt Basis					
Description	Debt 1	Debt 2	Debt 3	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. Combine 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					

## S Corp Basis Reporting

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. 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					

# S Corporations: Review and Update

## S Corp Reporting

For **2022** the IRS is adding two new questions:

- D How did you acquire your stock?
- E Do you have a 1.1367-1(g) election in place?



73

## S Corp K-1 Reporting

- In **2020** the IRS required reporting the number of shares and Loans from Shareholders on the K-1
- For **2021** the IRS is requiring the corporation to report the total number of shares, too!



74

# S Corporations: Review and Update



## §199A LOSSES

75

## §199A Losses

If **NET** qualified items for the year is less than zero, that amount is carried over as a loss from a qualified trade or business in the succeeding tax year.



76

# S Corporations: Review and Update

## §199A Losses

Prop Reg § 1.199A-1(c)(2)(i) clarifies that this carryover does not affect the deductibility of the losses this year for other purposes of the code.



77

## §199A Losses

- If your Net QBI is less than zero from on business, but your overall QBI is greater than zero, then you must offset the next income and loss from each trade or business before you apply the W-2 wage and depreciable basis limitation.
- **AND** W-2 wages and depreciable basis from loss businesses are not taken into account this year

**AND** are not carried over to next year

78

# S Corporations: Review and Update

## §199A Losses

Note that suspended losses carried forward from tax years beginning before 1/1/2018 are not taken into account for determining QBI

- *Basis, At Risk and Passive losses*

**SUSPENDED**

79

## §199A Losses

**The 2020 Form 8995 Instructions introduced a new Worksheet to track any such suspended losses or deductions**

### What's New

**A method to track losses or deductions suspended by other provisions.** A worksheet is added to provide a reasonable method to track and compute your previously disallowed losses or deductions to be included in your qualified business income deduction calculation for the year allowed. See [Tracking Losses or Deductions Suspended by Other Provisions](#), later.

80



# S Corporations: Review and Update

## QBI Loss Tracking Worksheet

Keep for Your Records 

**QBI Loss Tracking Worksheet**  
 Use this worksheet to track losses or deductions suspended by other provisions and attributable to QBI using FIFO method.  
 Code \_\_\_\_\_ [Enter the Code section limiting your loss].

**Part I Suspended & Allowed Losses**

	A. Total suspended losses in year of disallowance	B. QBI fixed percentage	C. Prior year suspended losses allowed	D. Allowed losses limited by other Code sections
1. Pre-2018		0.00%		
2. 2018		%		
3. 2019		%		
4. 2020		%		
5. 2021		%		
6. Total				

**Part II Non-QBI Suspended and Allowed Losses**

Allocable to Non-QBI

	E. Suspended losses	F. Allocated prior year suspended losses allowed	G(i). Utilized 2018	G(ii). Utilized 2019	G(iii). Utilized 2020	G(iv). Utilized 2021	H. Remaining suspended losses
1. Pre-2018							
2. 2018							
3. 2019							
4. 2020							
5. 2021							
6. Total							
7. Allocation of allowed losses limited by other Code sections							

**Part III QBI Suspended and Allowed Losses**

Allocable to QBI

	I. Suspended losses	J. Allocated prior year suspended losses allowed	K(i). Utilized 2018	K(ii). Utilized 2019	K(iii). Utilized 2020	K(iv). Utilized 2021	L. Remaining suspended losses
1. Pre-2018							
2. 2018							
3. 2019							
4. 2020							
5. 2021							
6. Total							
7. Allocation of allowed losses limited by other Code sections							
8. Total prior year suspended losses allowed that must be included in QBI							

81

## Concluding Thoughts



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*Thank You*

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82