Entity formation, basis, distributions, etc.

<table>
<tr><th></th><th>C corp</th><th>S corp</th><th>Partnership</th></tr>
<tr><td>Formation</td><td>Not taxable if section 351 is satisfied</td><td>Not taxable if section 351 is satisfed</td><td>Not taxable</td></tr>
<tr><td>Basis</td><td>Stock basis =
+ Cash contributed
+ NBV of assets contributed
+ FMV of services contributed
+ Gain recognized by SH
(Debt assumed by corp)
(Boot received by SH)</td><td>Tax basis = stock basis + debt basis

Stock basis =
+ Cash contributed
+ NBV of assets contributed
+ FMV of services contributed
+ Gain recognized by SH
(Debt assumed by corp)
(Boot received by SH)

Debt basis = direct SH loans to corp</td><td>Outside basis (OB, basis in ownership interest) =
+ Cash contributed
+ NBV of assets contributed
+ FMV of services contributed
+ % Share of partnership debt
(Total debt assumed by partnership) } Subtract out total amount assumed by other partners

Inside basis = partnership’s basis in the assets contributed to the partnership</td></tr>
<tr><td>Increases and decreases to basis</td><td>Increases:
Income/gain items
Additional contributions
Decreases:
Loss/deduction items
Distributions to SH</td><td>Increases:
Income/gain items
Additional contributions
Increases in SH loans to corp (increases debt basis)
Decreases:
Loss/deduction items
Distributions to SH
Repayment of SH loans to corp (decreases debt basis)</td><td>Increases:
Income/gain items
Additional contributions
Increase in share of partnership debt
Decreases:
Loss/deduction items
Distributions to SH
Decrease in share of partnership debt</td></tr>
<tr><td>Nonliquidating distributions</td><td>Taxable dividend to the extend of +CEP

Ordering of distribution source:<table><tr><th>Source (in Order)</th><th>Income to Shareholder</th><th>Effect on Shareholder Stock Basis</th></tr><tr><td>1. Current earnings and profits</td><td>Taxable dividend</td><td>None</td></tr><tr><td>2. Accumulated earnings and profits</td><td>Taxable dividend</td><td>None</td></tr><tr><td>3. Stock basis</td><td>None</td><td>Reduction</td></tr><tr><td>4. Distributions in excess of E&P and stock basis</td><td>Taxable capital gain</td><td>None (basis is $0)</td></tr></table>
Can net together -CEP and +AEP, but for +CEP and -AEP, distributions are only dividends to the extent of +CEP
For CEP, allocate pro rata based on distribution amounts
For AEP, pulled in order of distributions
Property distributions:</td><td>Usually not taxable to SH (already paid taxes on S corp earnings when it was flowed through)

Ordering of distribution source:<table><tr><th colspan="4">S Corporation With No C Corporation E&P</th></tr><tr><td></td><td>Distribution</td><td>Tax Result</td><td>Treatment</td></tr><tr><td>1st</td><td>To extent of S corporation AAA</td><td>Not subject to tax, reduces basis in stock</td><td>S corporation profits (already taxed)</td></tr><tr><td>2nd</td><td>To extent of S corporation OAA</td><td>Not subject to tax, reduces basis in stock</td><td>Nontaxable income/ related expenses</td></tr><tr><td>3rd</td><td>To extent of stock basis</td><td>Not subject to tax, reduces basis in stock</td><td>Return of capital</td></tr><tr><td>4th</td><td>In excess of stock basis</td><td>Taxed as long-term capital gain (if stock held for > one year)</td><td>Capital gain distribution</td></tr></table>
If there is prior year C corp E+P, it is pulled after S corp AAA but before S corp OAA and treated as a taxable dividend (unless elected to pull before AAA)
Property distributions:</td><td>Usually not taxable to SH (already paid taxes on partnership earnings when it was flowed through)

Ordering of basis reduction:
Remove cash distribution from basis<ol type="a">
If the distribution is only cash and exceeds OB, the excess between the cash amount and basis is a capital gain
Basis then reduced by NBV of assets distributed (cannot drop below 0)<ol type="a">
Sufficient remaining OB to cover the total NBV basis reduction – partner’s basis in the asset distributed is NBV (rolls over)
Insufficient remaining OB to cover the total NBV basis reduction – partner’s basis in the asset is reduced to the amount of remaining OB<ol type="i">
If multiple assets are distributed with insufficient OB, reduce basis of hot assets first (inventory and unrealized receivables for cash basis taxpayers)</td></tr>
</table>

	1. Corp recognizes gain as if the property was sold (does not recognize loss) 2. Gain is added to E+P 3. E+P reduced by FMV of property distributed 4. FMV of property received is taxable to SH to the extent of +CEP 5. SH's basis in property is now FMV)	1. Corp recognizes gain as if the property was sold (does not recognize loss) 2. Gain is added to AAA 3. AAA reduced by FMV of property distributed 4. SH's stock basis is increased by % share of the gain recognized by the corp and decreased by the FMV of the property 5. SH's basis in property is now FMV	
Liquidating distributions	Liquidating with proceeds after sale of property: ● Corp G/L = sale price of assets – basis in assets ● SH G/L = proceeds – stock basis Liquidating by transferring property directly: ● Corp G/L = FMV of asset distributed – basis of assets ● SH G/L = FMV of assets received – stock basis – debt assumed by SH from assets received	Liquidating with proceeds after sale of property: ● Corp G/L = sale price of assets – basis in assets ● SH G/L = proceeds – ending stock basis Liquidating by transferring property directly: ● Corp G/L = FMV of asset distributed – basis of assets ● SH G/L = FMV of assets received – ending stock basis – debt assumed by SH from assets received	Ordering of basis reduction (must be zeroed out): 1. Remove cash distribution from basis a. If the distribution is only cash and exceeds OB, the excess between the cash amount and basis is a capital gain b. If the distribution is only cash and does not cover the full amount of OB, the unrecovered basis is a loss 2. Any left over OB is then allocated to the rest of the assets distributed to bring basis to 0 a. If there is more OB remaining than basis in distributed assets, the assets get a stepped-up basis to cover the full OB amount (if hot assets only, they do not get stepped up. Taxpayer must recognize a loss for the unrecovered basis) b. If there is not enough OB remaining to cover the total NBV basis reduction, the OB must be allocated among the assets distributed (stepped-down basis) 3. If multiple asset classes are distributed, first get the difference between OB and IB. If OB exceeds IB, last class of assets need to be stepped up (only other property can be stepped up). If IB exceeds OB, last class of assets need to be stepped down (other property, or hot assets if they are the last category, can be stepped down). Adjust the last category of assets to FMV. Remove this adjustment from the remaining difference to be used up. Lastly, allocate any remaining difference after step 2 to all the assets in the last property category proportionally based on their relative adjusted basis after step 2

Equity compensation

	Non statutory without RDV	Non statutory with RDV	Statutory – ISOs 2/1 rule – held for 2 years after grant date and 1 year after exercise date	Statutory – ESPPs 2/1 rule – held for 2 years after grant date and 1 year after exercise date	Restricted stock
Grant date	N/A	Ordinary income = readily ascertained value of shares	N/A Option price cannot be lower than FMV @ grant Only for employees owning less than 10%	N/A Option price can be 85% of FMV @ grant, no lower Only for employees owning less than 5%	N/A If 83(b) election is made, ordinary income = FMV @ grant
Exercise/vest date	Ordinary income = FMV @ exercise – option price Holding period begins	N/A Holding period begins	N/A	N/A	Ordinary income = FMV @ vest Holding period begins
Basis	Basis = FMV @ exercise	Basis = option price + income recognized @ grant	Basis = option price	Basis = option price	FMV @ vest (or grant, if 83(b) election made)
Sale date	G/L = FMV @ sale – basis Type of G/L depends on holding period	G/L = FMV @ sale – basis Type of G/L depends on holding period	If 2/1 rule met: Capital G/L = FMV @ sale – basis (whole G/L is capital) If 2/1 rule not met, gain situation: Capital gain = FMV @ sale – FMV @ exercise Ordinary income = FMV @ exercise – option price (only excess gain is capital; bargain element gain is ordinary) If 2/1 rule not met, loss situation: Capital loss = FMV @ sale – basis (whole loss is capital)	If 2/1 rule met: Capital G/L = FMV @ sale – basis (whole G/L is capital) If 2/1 rule not met, gain situation: Capital gain = FMV @ sale – FMV @ exercise Ordinary income = FMV @ exercise – option price (only excess gain is capital; bargain element gain is ordinary) If 2/1 rule not met, loss situation: Capital G/L = FMV @ sale – basis (whole loss is capital) If strike price is less than FMV @ grant Ordinary income = lesser of: a. difference between FMV @ sale and FMV @ exercise b. difference between option price and FMV at grant	G/L = FMV @ sale – basis Type of G/L depends on holding period
Expired/not exercised	Capital loss = price paid for options (if any)	Capital loss = FMV of options previously taxed @ grant	Capital loss = price paid for options (if any)	Capital loss = price paid for options (if any)	N/A

Loss limitations

Limitation	Notes	Excess losses	If disposing of interest with suspended losses…
1. Tax basis limitation Business loss can only be deducted to the extent of tax basis	• Share of partnership debt is sometime included in tax basis depending on the type of partner and the type of debt	Carryforward indefinitely to offset future income when tax basis is reinstated	Loss disappears
2. At-risk limitation Losses clearing the tax basis limitation can only be deducted to the extent that the owner is "at risk" (same as tax basis, but now excluding nonrecourse debt)	• Qualified nonrecourse financing (ex: real estate mortgage) is still included in at risk basis even though it is nonrecourse	Carryforward indefinitely to offset future income when at-risk basis is reinstated	Loss can be used to offset any gains from selling the interest

3. Passive activity loss limitation
Net passive activity losses can only be offset against net passive activity income
	• Flow-through income separated into three categories:
	  o Active income (ex: salaries, guaranteed payments, etc.)
	  o Passive income
	  ▪ Income from activities in which the taxpayer does not materially participate (<500 hours a year)
	  ▪ Real estate income
	  ▪ Income from a limited partnership
	  o Portfolio income (ex: interest, dividends, capital G/L, etc.)
	• Real estate income is considered active income if the taxpayer is a real estate professional (>50% of services and 750 hours of services per year in real estate)
	• Mom-and-pop exception – individual taxpayer can deduct up to $25,000 of net passive activity losses due to real estate against other income if the taxpayer actively participates in management and owns at least 10% of the real estate activity
	  o $25,000 is reduced by 50% of taxpayer's excess AGI (excluding the rental activity) over $100,000
	• PALs are allocated across all entities with losses. Allocation to each entity = net PAL * (entity's individual loss / total of all losses)
		Carryforward indefinitely to offset future passive activity income	Loss can be used to offset any type of income

4. Excess business loss limitation The aggregate of business losses that have cleared the first three limitations are limited to $313,000 for single filers and $626,000 for MFJ filers	• Applies to all type of business income – active, passive, or portfolio	Carried forward as a NOL to offset 80% future income	

Recipient's basis in gifted/inherited property

Inherited property	FMV at date of death Erases built-in gains and losses
Inherited property – AVD elected	FMV at the earlier of distribution date of asset or six months after death
Gifted property – FMV at gift date > donor's rollover basis	Donor's rollover basis + any gift tax paid
Gifted property – FMV at gift date < donor's rollover basis Erases built-in losses	• Selling price > donor's rollover basis □ donor's rollover basis • Selling price < FMV at gift date □ FMV at date of gift • Selling price < donor's rollover basis and > FMV at gift date (middle point) □ Costs compared to competitor

Inheriting vs gifting summary chart

	Capital gains tax to recipient if gifted/inherited and then sold	Gift transfer tax Rate for estate and gift tax is the same	Estate transfer tax Rate or estate and gift tax is the same	Appreciating property	Depreciating property
Gifting while still alive	(FMV – basis) * capital gains rate	(FMV – annual exclusion) * transfer rate	N/A	Recipient: Gets low carryover basis and may face higher capital gains tax later. Donor: Locks in current FMV for transfer tax and removes future appreciation from estate.	Recipient: Cannot use donor's built-in loss for tax benefit. Donor: Pays transfer tax but removes a depressed-value asset from estate
Inheriting after death	N/A (step-up basis)	N/A	FMV * transfer rate	Recipient: Receives step-up in basis, eliminating capital gains tax on prior appreciation. Estate: Pays estate tax on full FMV at death.	Recipient: Receives step-down in basis, so built-in loss disappears. Estate: Pays estate tax on FMV despite loss being wasted.

Charitable donations

Type of property (in order that deduction should be applied)	Examples of property	Deduction amount	AGI limitation– public charity	AGI limitation – private operating foundation	AGI limitation – public private nonoperating foundation
1. Cash	Cash	Cash amount	60%	60%	30%
2. Ordinary income property	• Inventory • Short-term assets (less than 1 year) • Personal-use or investment assets that have depreciated in value • Depreciation recapture on business-use assets	Lesser of FMV at time of contribution or adjusted basis If the property is a personal-use vehicle that has depreciated in value and is later sold – use the lesser of FMV at time of contribution or gross proceeds from sale	50%	50%	30%
3. LTCG property	• Personal-use or investment assets that have appreciated in value • Gain in excess of depreciation recapture on business-use assets	FMV at time of contribution If the property is tangible personal property and the organization uses it for a purpose unrelated to their charitable mission (ex: auctioning it off) – use adjusted basis	30%	30%	20%

Retirement plans

	Traditional 401k	Roth 401k	Traditional deductible IRA	Traditional nondeductible IRA	Roth IRA	Annuity contract
Type	Employer-sponsored	Employer-sponsored	Individual	Individual	Individual	Individual
Available to…	Employees	Employees	Everyone (unless in a pension plan and make a lot of money)	Everyone	Everyone, subject to modified AGI limits	Everyone
Age that distributions can be taken without penalty	59.5 (55 if separated from service)	59.5 (55 if separated from service)	59.5	59.5		59.5
Contributions to plan made with…	Pre-tax dollars	After-tax dollars	Pre-tax dollars	After-tax dollars	After-tax dollars	After-tax dollars
Contribution deductibility	Deductible	Not deductible	Deductible	Not deductible	Not deductible	Not deductible
Contribution limits	$23,500 aggregated across all employer-sponsored accounts (increases as taxpayer nears retirement age)	$23,500 aggregated across all employer-sponsored accounts (increases as taxpayer nears retirement age)	Lesser of $7,000 per spouse or total earned income ($8.000 if over age 50)	Lesser of $7,000 per spouse or total earned income ($8.000 if over age 50)	Lesser of $7,000 per spouse or total earned income ($8.000 if over age 50)	N/A
Eligible for employer match?	Yes – match is not taxable income to employee	Yes – match is taxable income to employee	No	No	No	No
Required minimum distributions?	Yes – at the later of age 73 or when terminating employment	No	Yes – by April 1 of year after age 73	Yes – by April 1 of year after age 73	No	No
Distributions – contributions/principal	Taxable	Nontaxable	Taxable	Nontaxable	Nontaxable	Nontaxable
Distributions – earnings	Taxable	Nontaxable	Taxable	Taxable	Nontaxable	Taxable
Additional notes		Distributions are nontaxable only if they are qualified (taken after 59.5 and account has been open for at least 5 years). If not qualified, distributions are taxable on a pro rata basis of relative earnings vs contributions			Distributions are nontaxable only if they are qualified (taken after 59.5/due to disability/due to first time homeowner/due to death of taxpayer and distribution given to beneficiary, and account has been open for at least 5 years). If not qualified, distributions are taxable, and considered to come first out of principle	