

# T1: Individuals

## Two Basic Tax Strategies

- Defer taxable income
- Accelerate tax deductions

## Equity Compensation Awards

- Statutory or Nonstatutory stock options (capital gain/losses)
- Restricted Stock Awards: EE tax as ordinary compensation for FMV on vest date
- Stock Appreciation Rights (SARs): EE receives payment = FMV on exercise - FMV on SAR granted date

## Nonstatutory Stock Options

- **If option has readily determinable value** (transferable, exercisable immediately, no conditions/restrictions, FV readily determined)
  - Taxed when granted
  - Ordinary compensation income = value of option at grant date - cost to the employee
  - Basis when option exercised = exercise price + amount taxed at date of grant
- **If option as no readily determinable value**
  - Taxed when exercised
  - Ordinary compensation income = FMV - cost of stock
  - Basis when exercised = FMV

## Kiddie Tax

- Standard deduction is greater of
  - \$1,350
  - Earned income + \$450
- Net unearned income in excess of \$2,700 is taxed at parent's rate

## Loss Limitations

**Apply to flow through entities at entity level**

1. Tax basis limitation
2. At risk limitation

**Apply to individual taxpayers at individual level**

3. Passive activity loss limitation
4. Excess business loss limitation

## (1) Tax Basis Limitation

- Losses can be flowed to owner's income tax return to extent of owner's tax basis
- Excess loss suspended until tax basis is reinstated; carried forward forever
  - Any suspended losses remaining when owner disposes of interest are **LOST !!!**

## (2) At Risk Limitation

- Losses can be flowed to owner's income tax return to extent of owner's economic risk
  - Same as tax basis **excluding** owner's share of nonrecourse debt
- Loss in excess is suspended until reinstated; carried forward forever
  - Any suspended losses remaining when owner disposes of interest can be used to **offset gains** on sale of interest

## Statutory Stock Options: Not taxed as compensation income

- Incentive Stock Options (ISO)
  - Employee can't own > 10% of voting power
  - Exercise price may not be less than FMV at grant date
  - Exercise within 10 years
- Employee Stock Purchase Plans (ESPP)
  - Employee can't own > 5% of voting power
  - Exercise price may not be less than lesser of 85% of FMV on grant or exercise date
  - Can't acquire more than \$25,000 in 1 year ; Exercise within 27 months

## Foreign-earned income Exclusion

\$130,000 if bona fide and physical presence test is met (330 days in foreign country)

## Alternative Minimum Taxable Income

- Adjustments (PANIC TS)
  - Passive adjustment losses added back
  - Accelerated depreciation
  - Net operating loss is recalculated
  - Installment method
  - Contracts (LT)
  - Taxes deducted added back
  - Standard deduction is added back
- Tax Preferences (PPP) - always ADDED back
  - Private activity bond tax-exempt interest income
  - Percentage depletion deduction
  - Pre-1987 accelerated depreciation over straight line for real property

## Estimated Tax Payments

- Must pay quarterly payments (or withhold from wages) if expected to owe \$1,000+
- Underpayment penalties avoided if
  - owe less than \$1,000
  - Tax prepayments for year are at least
    - 90% of CY taxes
    - 100% of PY taxes ; 110% if PY AGI > \$150,000
- Failure to pay penalty: 0.05%/month, up to 25% of unpaid tax

## Risk Management Method

- High loss severity + High frequency: Risk avoidance.
- Low loss severity + High frequency: Risk reduction.
- Low loss severity + Low frequency: Risk retention.
- High loss severity + Low frequency: Risk transfer.

## Risk Mitigation

- Avoidance: Remove the risk entirely.
- Reduction: Decrease the severity of the risk.
- Retention: Absorb the risk internally.
- Transfer: Shift risk to another party, typically via insurance.

## FSA vs HSA

- **Flexible Savings Account**
  - Maximum annual contribution: \$3,300
  - USE IT OR LOSE IT
  - Carryover \$660 to following year
- **Health Savings Account**
  - Maximum contribution: \$4,300 for self, \$8,550 for family plan
  - Increased by \$1,000 if age 55+
  - Continue to accumulate
  - must have **HDHP**: min deduction \$1,650 for self, \$3,300 for family
    - out of pocket exp: \$8,300 for self, \$16,600 for family

## (3) Passive Activity Loss Limitation

- Passive activity: taxpayer doesn't materially participate
  - Rental real estate is passive unless taxpayer is a real estate professional
- Passive activity loss can only offset passive activity income
- Loss in excess is suspended until reinstated
  - Any suspended losses remaining when owner disposes of interest can **OFFSET ANY TYPE** of income !!!
- Mom and Pop exception for rental real estate:
  - can deduct up to \$25,000 of rental real estate loss if
    - actively participate & owns at least 10%
  - \$25,000 starts phasing out when taxpayer AGI exceeds \$100,000; fully eliminated when AGI > \$150,000

## (4) Excess Business Loss Limitation

- Limited to \$313,000 (single) or \$626,000 MFJ
- Any excess loss is carried forward as an NOL and subject to 80% income limitation for deduction of NOL carryforwards

## Risk

- Nonsystematic: unique to certain industry
  - mitigated by diversifying investments
- Systematic: affects entire system
  - can be mitigated by short selling stocks or investing in derivatives
  - EX: Currency, Inflation, Sociopolitical risk

## Income Types

### Active:

- Salaries and wages
- Materially participated business income/loss

### Passive:

- Not materially participated business income/loss
- Rental real estate
- Income/Loss from limited partnership

### Portfolio:

- Dividends
- Interest

# T1: Individuals

## Gift Taxation

- Donor pays gift tax
- Annual exclusion for gifts:
  - \$19,000 single ; 36,000 MFJ
- Exclusion applies to each donee
- Unlimited exclusions for
  - (1) Direct to educational institutions
  - (2) Direct to healthcare
  - (3) Charity
  - (4) Spouse
- Lifetime gift and estate tax exclusion: \$13,990,000
- Ineligible exclusion for
  - Future interest gifts (still subject to gift tax)
  - Incomplete gifts (not eligible for gift tax)
- Imputed interest is limited to borrower's net investment income
  - If < \$1,000 imputed interest = 0
- Imputed interest = AFR interest - actual interest

## ER Sponsored Retirement Plans

- defined benefit = ER bears investment risk (aka pension plan)
- defined contribution = EE bears investment risk (like 401(k))
  - ER does not promise specific benefit payment to EE upon retirement

## Section 401(k) Plans

- EE Sponsored
- Maximum EE contribution: \$23,500 (additional \$7,500 if 50-59 or 64+ ; \$11,250 if 60-63)
- Maximum combined ER and EE contributions: \$70K
- Traditional: distributions of principal and earnings are taxable as ordinary income
  - RMDs required or penalty - Age 73 or EE terminated
- Roth: contributions taxable when put in; distributions of principal are nontaxable; earnings only taxable if non qualified
  - Qualified: open for at least 5 yrs & age 59 1/2+
- Exceptions for premature distributions penalty of 10%
  - M - medical expenses excess of AGI floor
  - A - adoption or birth of child (\$5k max)
  - D - disability (total & permanent)
  - D - divorce
  - D - disaster (federally declared, \$22k max)
  - T - terminal illness or death
  - E - emergency expenses (\$1k per year)
  - D - domestic abuse victims (lesser of \$10,300 or 50% of account)

## Educational Plans

- 529 Plans: Tax-deferred savings for education
  - Prepaid Tuition (guaranteed against tuition inflation)
  - Educational Savings (invested, subject to market risk).
- Coverdell Accounts: Up to \$2,000/year for K-12 and college expenses, tax-free if used for qualified expenses.
- Series EE Bonds: Interest tax-free if used for education
- Student Loans: Stafford (subsidized/unsubsidized) and PLUS loans for parents, with up to \$2,500 in annual interest deductions.
- Grants and Scholarships: Non-repayable aid; tax-free if used for qualified expenses

## Gifts of Noncash Property

- Valued @ FMV on date of gift
- Recipient's tax basis of **gifted** property:
  - FMV > Rollover → use ROLLOVER
  - SP > Rollover → use ROLLOVER
  - SP < FMV → use FMV
  - FMV < SP < Rollover → NO G/L
- Recipient's tax basis in **inherited** property = **FMV** of property at date of death or AVD (exclusion NOT available for property transferred at death)

## Gifts of Noncash Property To Charity

- Ordinary Income Property (inventory, assets held ST, investment that have depreciated) deduction is LESSER of: (1) Adjusted basis or (2) FMV at time of donation
- LTCG Property deduction = FMV at time of donation
  - Deduction for donation of appreciated personal property is limited to adjusted basis if charity uses for unrelated
- Donation of personal-use vehicle sold:
  - if FMV > \$500, deduction lesser of gross proceeds or FMV
  - if sold for < \$500, deduction lesser of \$500 or FMV

## Selecting Retirement Plans

- Traditional = current marginal tax rate > expected future marginal tax rate
- Roth = current marginal tax rate < expected future marginal tax rate

## IRA Plans

- Individual investment that grows tax-deferred
- Maximum contribution: lesser of
  - Single: earned income or \$7,000
  - \$8,000 for age 50+
- Roth IRA
  - Contributions are nondeductible
  - Distributions of principal never taxable
  - Distributions of earnings taxable if nonqualified
- Traditional IRA
  - Contributions deductible as adjustment to AGI
  - Distributions of earnings are taxable
  - Distributions of principal as ordinary income if taxpayer took deduction for contributions
- Exceptions for premature distributions penalty of 10%
  - H - homebuyer (first time, \$10k max)
  - I - insurance (health), unemployed 12 weeks
  - M - medical expenses in excess of AGI floor
  - D - disability
  - E - education
  - A - adoption or birth of child (\$5k max)
  - D - disaster, federally declared (\$22k max)
  - T - terminal illness or death
  - E - emergency expenses (\$1k per year)
  - D - domestic abuse victims (lesser of \$10,300 or 50% of account)

## After-tax return on investment

- ROI = (Investment Sales Price - Cost of Investment) / Cost of investment
- ATRR = ROI × (1 - Tax Rate)

## AGI Limits for Charitable Contributions (excess carried forward for 5 years)

Cash:

- Public or private charities: 60% of AGI
- Private Nonoperating Foundations: 50% of AGI

Ordinary Income Property:

- Public or private charities: 50% of AGI
- Private Nonoperating Foundations: 30% of AGI

LTCG Property:

- Public or private charities: 30% of AGI
- Private Nonoperating Foundations: 20% of AGI

## Self Employed Retirement Plans

- SEP IRA: 25% of compensation or \$70k
- SIMPLE IRA: 100% of compensation or \$16,500
- Solo 401(k): 20% of NI - ½ SE tax or \$70K
- Contributions to traditional self-employed plans are deductible as adjustment to AGI
- Funds grow tax deferred
- All plans have a maximum contribution based on self-employment income reduced by one half of self-employment tax deduction

## Nontaxable options for unused Section 529 Plan funds:

- Save for future educational needs
- Transfer \$ to family member
- Withdraw to \$10,000 to pay for qualified education loans
- Roll over to beneficiary's Roth IRA (\$35,000 limit)

# T2: Corporations

## Net Operating Losses

- NOL pre-2018:
  - carryback 2 yrs, forward 20 years, offset 100% of taxable income
- NOL for 2018-2020
  - carryback 5 years, forward forever
  - Offset 100% of taxable income
- NOL for 2021 & after
  - Carryback not allowed, forward forever
  - Offset 80% of taxable income
- No charitable contribution deduction

## Section 382

- Ownership change occurs when 1+ 5% shareholders increase ownership by more than 50% in testing period (3 years prior to & including date of ownership change)
  - Limitation = FMV of loss corp. b4 change \* federal LT tax-exempt rate

## Capital Losses

- Can only offset capital gains
- Carryback 3 years, forward 5 years
- DRD:** choose lesser of 2 unless creates NOL, % dividends received OR % \* taxable income
  - Percentage ownership:**
    - 0% < 20% = 50% DRD
    - 20% < 80% = 65% DRD
    - > 80% = 100% DRD

## CORPORATIONS

- Gain realized = FMV of what i get = NBV of what i give
- Gain recongized = nontaxable if no boot
- tax basis in stock = NBV of what i give - liabilities assumed
- corp's basis in property = GREATER of NBV + boot or liability assumed - cash

## Foreign Sub vs Branch

- Foreign Branch:** extension of the domestic corporation, unincorporated; Income taxed by foreign host country and U.S.
- Foreign Subsidiary:** legally separate entity incorporated in foreign country; profits are taxed in the host country, but U.S. can tax the income when brought back to the U.S.

## US Activities on Foreign People

- Inbound Transactions** = foreign person's investment in US
  - Foreign ppl generally only taxed on U.S.-source income, but may be treated as U.S. residents (& taxed on worldwide income) if they meet substantial presence test
- Substantial Presence Test:**
  - Foreign individual must be present in U.S. for at least 31 days in CY and total of 183 days over 3-year period (w/ weighted average calculation)
- Outbound transactions** = US person invests abroad
  - anti-deferral rules:
    - (1) passive foreign investment company - PFIC
    - (2) subpart F regime

## Expatriation

- market to market tax regime
  - (1) tax liability test
  - (2) net worth test
  - (3) compliance test

## Formation of C Corps

- Corporation:** No gain/loss recognized
  - Basis = GREATER of
    - shareholder's basis in property
    - debt assumed by corp
- Shareholder:** No gain/loss recognized if contributing property shareholders own at least 80% & NO BOOT RECEIVED (cash/debt relief)
  - Shareholder who contributes service recognize Ordinary Income in FMV of services provided
  - Basis** = cash contributed + NBV of property contributed - any debt on property assumed + FMV of any services provided + any gain recognized by shareholder
  - Gain recognition:** FMV of any boot received
    - Recognized to extent that liabilities assumed by Corp exceed SH adjusted basis

## Section 1244 Small Business Stock

- if stock is sold or becomes worthless
- Ordinary loss up to \$50,000 single, \$100,000 MFJ for original shareholder

## Qualified Small Business Stock:

Noncorporate shareholder holds QSBS for > 5 years may exclude 100% of gain on sale or exchange of stock

## Foreign Tax Credit Limitation

= (Foreign-source income / Total taxable income) × U.S. tax on total taxable income

## Transfer Pricing

- Ensures that intercompany transactions (sales of goods, services, loans, etc.) between related companies (called controlled taxpayers) are conducted as if they were between unrelated parties (arm's-length principle)
- IRS can adjust the taxable income reported from controlled transactions to ensure consistency with the arm's-length standard.

## Tax Planning

- Timing
- Incoming Shifting
- Estimated Payments

## Sourcing of Income

- Interest:** Sourced where the entity paying the interest is located
- Dividends:** Sourced where dividend-paying company is located
- Personal Services:** Sourced where services are performed.
- Rents & Royalties:** Based on where property is located (tangible) or used (intangible)
- Disposition of Real Property:** Gains sourced where property is located

## Corporate Distributions

- Taxable if classified as dividends
- Distribution allocation
  - (1) current E&P = taxable dividend; no effect on stock basis
  - (2) accumulated E&P = taxable dividend; no effect on stock basis
  - (3) stock basis = nontaxable return of capital; reduces stock basis
  - (4) excess over stock basis = taxable capital gain; no effect on stock basis
- when dividends in excess of E&P, current pro rate & accumulated applied chronological
- Dividend** = FMV of property or cash
- Appreciated property distributed, corporation recognize gain if property sold
  - No loss for depreciated property

## Corporate Liquidation

- Corp and shareholders recognize G/L**
  - Corp recognizes gain if assets distributed were sold (proceeds - stock basis)
  - Shareholder recognizes gain for FMV of assets distributed - SH basis in stock
    - SH basis in assets = FMV of assets
- Tax-Free reorganizations:** no G/L if parent owns > 80%
  - SH basis = NBV

## Corp/SH loans

- Imputed interest is dividend income to SH if they're an EE
- Imputed interest = AFR - actual rate on below market loan

## Consolidated Tax Return

- Affiliated group of corps (> 80% ownership)
- Remove elims, intercompany sales, intercompany dividends, etc.
- NOT allowed to file:** FIRES (foreign, insurance, real estate investment trust, exempt orgs, S corps); brother-sister corps
- Advantages
  - NOL carryovers can be used against other group income
  - Capital losses can offset other group capital gains
- Disadvantages
  - Not all states allow; Tax credits may be limited

## Advance Pricing Agreement Program (APMA)

mission to resolve actual/potential transfer pricing disputes in timely, principled, cooperative manner

**(1) Timing Strategy:** NOL carryovers, changes in tax legislation, or marginal tax rates

- When rates decrease or remain constant:
  - Marginal tax rate = same or lower in future years
  - Discount factor & PV lower in future years
- When rates increase:
  - Marginal tax rate = higher in future years
  - Discount factor = lower in future years
  - PV may be higher or lower in future year

**(2) Incoming Shifting Strategy:** paying salaries to shareholder-employees or noncash property transactions

**(2) Estimated Quarterly Payments:** 100% of lower of PY tax liability, CY tax liability, or CY tax liability using annualized TI

- Each payment = 25% of tax liability
  - 100% of tax liability in CY
  - 100% of tax liability on PY return (only 1st quarter)
  - 100% of estimated liability in CY by annualizing taxable income

# T3: Flow-Through & Other Entities

## Types of entities

- C corp (1120)
- S Corp (1120S)
- Partnership (1065)
- Sole proprietorship (1040, Sch C)

## S Corporations

- Taxed similar to partnerships; no personal liability
- Realized and Recognized G/L are same as C corps
- Contribution is nontaxable if/
  - property contribution
  - solely in exchange for stock
  - owner obtained 80% control

**Tax basis limit = stock basis + debt basis**

## At risk limit

- at-risk amount = stock basis + debt basis - nonrecourse loans
- When disposed of stock suspended loss, can offset against gain of sale

## Nonliquidating Distributions (S-Corp)

- **(1) to extent of S Corp AAA**
  - nontaxable; decreases stock basis
- **(2) to extent of C Corp E&P**
  - taxed as dividend; no effect on basis
- **(3) to extent of S Corp OAA**
  - nontaxable; decreases stock basis
- **(4) to extent of stock basis**
  - nontaxable return of capital; decreases stock basis
- **(5) in excess of stock basis**
  - taxed as LTCG

## Forming a Partnership

- Partner: No gain/loss recognized for property contribution
  - Ordinary income for FMV of services contributed
  - Contributed property with excess liability = taxable gain for boot
- Partnership: No gain/loss recognized
  - Partnership's basis = same as contributing partner's basis in property

## Nonliquidating Distributions (Partnership)

- Nontaxable
- Partner's interest is reduced by cash then NBV of property; can't go negative
- Property distribution: when partners outside basis > inside basis
  - partner's interest basis reduced by adjusted basis of property distributed
  - partner's basis in property distributed = same as partnership's basis in property
- Property distribution: when partners outside basis < inside basis
  - partner's interest basis reduced to 0
  - partner recognizes a capital gain if cash > basis for the excess

## C Corp -> S Corp

- LIFO recapture tax: excess of inventory computed using FIFO method over the inventory computed using LIFO must be included in taxable income
- Built-in Gains Tax: unrealized gain when c corp elects s corp status & FMV > NBV at election date
  - Tax = 21% × LESSER of:
    - (1) Gain recognized this year
    - (2) built in gain remaining (gain that existed on date of the S election)
    - (3) S corp's taxable income as if still C corp
- Tax on Passive Investment Income: imposed when S corp has C corp accumulated E&P, and passive income that exceeds 25% of gross receipts
  - 21% tax on LESSER of NI or excess passive investment income

**S corporation shareholders have a separate debt basis from stock**

## S Corp Liquidation

- Same as C corp
- Consequences to S corp:
  - recognize gain/loss on distributions of property as if they were sold at FMV
    - FMV - NBV = taxable gain/loss
- Consequences to Shareholder:
  - payment in exchange for stock
  - recognize taxable gain/loss = amount realized (FMV of property received) - basis in stock
    - Basis = FMV @ date of distribution

## Inside vs Outside

- Inside: partnership's basis in property contributed
- Outside: partner's basis in partnership interest

## Types of Debt

- Nonrecourse: secured by property, creditor only has right to take property not personal assets
- Recourse: debts for which a partner has personal liability

## Partnership Liquidation

- Nontaxable; 0 out to get out
- Gain recognized for any cash distribution in excess of partner's basis
- Loss recognized if partner's basis in interest > partnership's assets distributed

## Hot assets

- assets that result in ordinary income when sold
  - inventory; accounts receivable

## Sale of Partnership Interest

- Gain/Loss = amount realized (including relief from share of liabilities) - adjusted partner's basis
  - capital gain unless represents share of hot assets
    - treated as ordinary income
  - allocate based on # of days

## Shareholder Stock Basis

Initial stock basis (cash, NBV property, FMV services)  
 + additional contributions  
 + income items  
 - distributions to shareholders  
 - nondeductible expenses  
 - loss/deduction items  
 = ending basis in S corporation stock

## Accumulated Adjustments Account (AAA)

- Increases:
  - Ordinary Business Income
  - Separately Stated income/gain
- Decreases:
  - Ordinary Business Loss
  - Separately stated losses/deductions
  - Nondeductible expenses
  - Distributions
- May be negative but distributions can't reduce AAA below 0

## OAA

Separate account for tax exempt income and related expenses and federal taxes paid by S corp that relates to prior C corp years

## Separately Stated Items

- Rental real estate income/loss
- Portfolio income
- Net Section 1231 gain/loss
- Charitable Contributions
- Section 179 expense deduction

## Adjustments to partnership basis

- Increases:
  - additional contributions
  - more partnership debt
  - taxable income/gain
  - tax-exempt income
- Decreases
  - distributions
  - decrease in partnership debt
  - nondeductible expenses

## Outside basis < Inside basis

1. assign basis to all assets equal to partnership's basis in assets
2. adjust basis of any assets in last property category that have **depreciated** in value **down** to FMV
3. allocate remaining basis in partnership interest among all assets in last property category based on relative adjusted basis after step 2

## Outside basis > Inside basis

1. assign basis to all assets equal to partnership's basis in assets
2. adjust basis of any assets in the last property category that have **appreciated** in value **up** to FMV
3. allocate remaining basis in partnership interest among all assets in last property category based on relative FMV

# T3: Flow-Through & Other Entities

## Contribution of Property

- C and S Corps must have 80% control to avoid recognizing gain on contribution of appreciated property to business
  - SH basis = NBV - liabilities assumed
  - corp's basis = NBV
- Partnerships: NO 80% control requirement; always NONTAXABLE
  - partner's basis in PS = NBV - liabilities assumed
  - PS's basis in contribution = NBV
  - Any pre-contribution (or built in gain) gain or loss is allocated to contributing partner when contributed property is sold by partnership
- Most Advantageous: avoid gain recognition
  - partnership
  - sole proprietorship

## Deduction of Business Losses

- C corp NOL: carry forward to offset TI up to 80%
- Flow through entities: if owner has sufficient basis in ownership interest and is actively involved, owner can IMMEDIATELY deduct losses against other sources of income
- Most advantageous: generally, PS or S corp because NOL not limited

## Types of Trusts

- Grantor: grantor retains certain ownership powers or control over property transferred to trust
  - revocable living trust
  - trust income/deductions are passed through & included on grantor's income tax return whether income stays in trust or is distributed
- Non-grantor: separate taxpaying entity
  - **simple**:
    - required to distribute all income to beneficiaries annually
    - can't make distributions from principal (corpus)
    - can't make contributions to charity
  - **Complex**: didn't meet all (3) requirements of simple trusts

## Taxation of Trusts

- Most trust income and expenses allocated to TAI
  - capital and casualty gains/loss allocated to corpus
  - trust admin expenses allocated as designated
- Exemption amount
  - Simple: \$300 ; Complex: \$100
- Trust taxable = all taxable income
  - tax exempt interest income & portion of admin expenses not included in calculating taxable income
  - capital gains/losses included
- DNI: limit on number of distributions included in beneficiaries' taxable income

## Section 501(c)(3) organization

- Must be C corp, unincorporated association, or trust
- Must be for exempt purpose: charity, religion, education, scientific
- Can't be for benefit of private interests
- May not participate in political campaign activity

## Taxation of Business Entity Income

- C Corp: taxed at 21% flat rate
  - taxed again at ownership level when distributed dividends
    - 0/15/20 % + possible 3.8% NII
- Flow-Through: taxed when earned, at ordinary tax rates
  - 10,12,22,24,32,35 and 37%
- Sole proprietorship and nonpassive partnership income:
  - subject to additional 15.3% SE tax
- S Corp: not subject to SE tax
- S corp, Partnership and sole proprietorship, may be eligible for QBI deduction (20% of QBI)
- Most advantageous: depends on marginal tax rate of individual owners relative to C corp rate and to extent of which business retains earnings or distributes earnings to owners

## Compensation of Owners

- C and S corps can pay and deduct salaries as well as SS and Medicare taxes
  - fringe benefits:
    - nontaxable for C corp
    - nontaxable for S Corp if own < 2%
- Partners do not receive salary, but partnership can deduct guaranteed payments
  - Partner pays all SS and Medicare taxes through SE taxes
- Sole proprietorship can't pay owner a salary or fringe benefits
- Most advantageous: C corp or S corp because they can deduct EE portion of taxes

## Nonliquidating Distributions to Owners

- C Corp Distributions
  - SH Tax Treatment: taxable dividend to extent of E&P; qualified dividends are taxed at individual shareholder income tax rates and may be subject to NII tax
  - Property distribution: Corp recognizes gain on appreciated property
    - SH has taxable dividend and basis in property = FMV at date of distribution
- S corporation distributions
  - SH Tax Treatment:
    - From S corp E&P (AAA): nontaxable, decreases SH basis
    - From C corp E&P: taxable dividend, doesn't impact stock basis
    - From SH remaining stock basis: nontaxable, decreases stock basis to 0
    - distribution in excess of stock basis: taxable capital gain
  - Property distribution: S corp recognizes gain on appreciated property and flows to SH
    - SH basis in property = FMV at date of distribution
- Partnership Distributions
  - Partner tax treatment: nontaxable to extent of partner's basis in partnership interest, decreases basis in partnership interest
  - Property distribution: no gain/loss recognized by anybody
    - Partner's basis in property = partnership adjusted basis
- Sole Proprietorship: owner withdrawals are not taxable
- Most advantageous: generally, partnership (especially if distribution of appreciated property) because no gain recognized, & amount is adjusted basis rather than FMV

## Liquidating Distributions to Owners

- C Corp Distributions
  - Corp recognizes gain/loss = FMV of property - adjusted basis
  - SH recognizes **capital** gain/loss = FMV - shareholder stock basis
    - basis in property = FMV at date of distribution
- S corporation distributions
  - Corp recognizes gain/loss = FMV of property - adjusted basis
    - flows to shareholders
  - SH recognizes **capital** gain/loss = FMV - shareholder stock basis
    - basis in property = FMV at date of distribution
- Partnership Distributions
  - no gain/loss recognized
    - only if cash distributed is more/less than partner's basis in PS interest
  - Partner's ending basis after a decrease for cash distribution is assigned to noncash property distributed to partner
- Most advantageous: generally, partnership (especially if distribution of appreciated property) bc no gain recognized, and amount is adjusted basis rather than FMV
  - If depreciated property, generally a C corp or S corp bc losses can be recognized @ time of distribution

UBI: activity that's a trade or business, regularly carried on, and NOT substantially related to organization's tax-exempt purpose

## Excluded Income from UBI

- Dividends, interest, annuities
- Royalties
- Income from research by college
- Rents from real property

## Excluded Activities from UBI

- Bingo games ; trade show
- Convivence of members
- Sale of merchandise received as gifts

# T4: Property Transactions

## Calc of Gain or Loss on Disposition

- Amount realized - adjusted basis of asset sold = gain or loss realized
- Amount realized = cash received, FMV of services or property received, and debt assumed by buyer
- Adjusted basis = original basis (cost if purchased, rollover cost or FMV if a gift) - accumulated depreciation

## Character of gain or loss

- Capital assets:** assets held for investment or personal use (NONbusiness, real or personal property)
- Noncapital:**
  - Ordinary
    - inventory
    - accounts receivable
    - short-term trade/business use
    - original use
    - treasury stock

## Gains (Excluded or Deferred) - HIDE IT

- Homeowner's exclusion:** exclude gain on sale of home up to \$500K (MFJ) or \$250K (single)
  - must own and use as principal residence for 2/5 years before sale ; only qualified use
- Involuntary conversion:** property taken away or destroyed
  - no gain recognized if reinvest insurance proceeds in a property similar or related in service within 2 years
    - recognize gain for un-reinvested proceeds
  - cost basis of replacement property = cost of new - unrecognized gain
- Divorce settlement:** lump sum payment or one-time property settlement ; nontaxable
  - holding period and basis is carryover/NBV
- Exchange of like-kind REAL property:** gain/loss is deferred
  - gain recognized to extent of boot received
  - !!! Net the debt !!!
  - basis = FMV of property received - deferred gain + deferred loss
  - REAL property used in trade/business or held for investment (personal property doesn't qualify)
- Installment sale:** revenue is reported over period in which cash payments are received
  - (1) GP = sales price - adjusted basis
  - (2) GP % = GP/sales price
  - (3) gain recognized = cash collections (excluding interest) \* GP %
- Treasury and capital stock:** NO G/L when selling, repurchasing, or reissuing own stock

## Section 1231 LT Trade or Business Assets

- Section 1231 long term trade/business use, held for more than 12 months:
  - Net 1231 gain (loss):
    - Loss: ordinary loss (future gain may be treated as ordinary income)
    - Gain: capital gain after any depreciation recapture
- 5-year look back:** pay back/recapture any 1231 losses deducted as ordinary losses, so 1231 gain is ordinary income to extent of prior losses
  - an unrecaptured section 1250 gain is treated as ordinary income first, then regular section 1231 gain
    - any remaining after 5-year lookback is taxed at 25% section 1250 rate
  - any regular net section 1231 gain after 5 year lookback is a long-term capital gain

## Like-Kind Exchanges

- Gain/Loss realized = amount realized (FMV of new property) - adjusted basis of property given up
- Gain/Loss recognized:
  - Loss is never recognized
  - Gain is lesser of:
    - Realized gain
    - Taxable boot
- Gain/loss deferred = gain realized - gain recognized
- Basis of new property = FMV of property received - deferred gain + deferred loss

## Section 1245 (PERSONAL property)

- Personal property sold @ a gain:
  - lesser of (treated as ordinary income)
    - gain recognized or A/D
- Remaining is netted with other section 1231 gains or losses for the year

## Section 1250 (REAL property)

- Individuals only !!!
- Gain on sale of depreciable property is ALL section 1231 gain
- If there is a net 1231 gain for year, lesser of (1) recognized gain or (2) A/D = "unrecaptured section 1250 gain"
- Remaining is netted with other section 1231 gains or losses for the year

## Section 291

- C Corporations only !!!
- Real property sold @ gain
  - 20% of lesser of treated as ordinary income:
    - Gain or A/D
  - Remaining is netted with other section 1231 gains or losses for the year

## Constructive Ownership

- Stock owned directly/indirectly by corp, partnership is treated as owned proportionately by shareholders, partners, beneficiaries
- An individual shall be considered as owning stock by related family members
- Stock constructively owned by a person under Rule 1 above shall be treated as actually owned by that person for the purposes of applying rule 1 or 2 in other situations

## Gain/Loss for related parties

- Gain rule:** recognized only to extent that future sales price > previous relative's cost basis
- Loss rule:** recognized only to extent that sales price to unrelated party is lower than the acquiring relative's purchase price
- No gain/loss rule:** no G/L recognized when sales price to unrelated party is between original cost basis and related party purchase price

## Related Parties

- Related parties include:
  - relatives
  - siblings
  - spouses
  - ancestors
  - lineal descendants
  - entities and greater than 50% owners
  - controlled groups
- Related party losses are disallowed

- Sell higher → Use "Relative's Basis" to determine gain.

Relative's Basis

- Sell between → No gain or loss.

Lower Purchase Price by Relative

- Sell lower → Use "Purchase Price" to determine loss.