E & P

What is E&P?	a tax concept — not defined in the Code — that measures a corporation's economic ability to pay dividends without impairing its capital
	the tax version of "retained earnings,"
	Upper limit on the amount shareholders must recognize as dividend income
	Includes current year E&P plus accumulated E&P
No statute of limitations	the IRS can always redetermine E&P, so corporations should keep meticulous records
Current E&P	Taxable income adjusted for the current year. Calculated by adding back excluded items and subtracting certain nondeductible items.
Accumulated E&P	Sum of all prior years' current E&P since 1913, reduced by prior distributions from E&P. A running balance carried forward year to year.
Computing E&P	Start with taxable income, then apply adjustments. The goal is to reflect actual economic capacity to pay dividends.

§§351 && 357

§351 the basic rule	No gain or loss is recognized when property is transferred to a corporation solely in exchange for stock, IF the transferors control the corporation (own ≥80% immediately after).
	Services ≠ property → transferor of services does NOT count toward 80% control and must recognize ordinary income on the FMV of stock received for services.
	Boot received (non-stock consideration) triggers gain recognition
	recognized gain = lesser of boot received or realized gain. Losses are never recognized.
§351 shareholder's stock basis	
Shareholder's stock basis =	Basis of property transferred
	+ Gain recognized
	− Boot received
	− Liabilities assumed by the corp
Corporation's basis in the asset =	transferor's basis

§§351 && 357 (cont)

	+ any gain recognized by the transferor (also called a carryover basis).
§357 General rule (a)	Liability assumed is NOT boot for gain recognition
	But it DOES reduce the shareholder's stock basis.
Exception 1: (b)	
If the liability lacks a business purpose or is a tax avoidance device →	ENTIRE liability amount is treated as boot (taints all liabilities)
Exception 2 (c)	
If total liabilities assumed EXCEED the basis of ALL assets transferred	recognized gain = excess (liabilities − total basis)
	This prevents a negative stock basis.

§357(b) predominates over §357(c). If both apply, use §357(b) — the larger gain recognition rules (all liabilities as boot).

Cash basis taxpayers: accounts payable are excluded from §357(c)

Redemptions & Complete liquidations

Redemptions:	qualifying vs. non-qualifying
non-qualifying =	dividend distribution
	tax at ordinary rates up to E&P
qualifying =	sale-or-exchange treatment

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Redemptions & Complete liquidations (cont)

	gain/loss = proceeds − stock basis
Four qualifiers §302(b)	(1) complete termination of interest
	(2) substantially disproportionate
	shareholder drops below 50% voting and ratio of shares drops to 80% or less of pre-redemption %
	(3) not essentially equivalent to a dividend
	(4) partial liquidation (corpo event)
Corpo effects-redemption	Corpo recognizes gain on distribution of appreciated property
	deemed sale
	Loss → NOT recognized
How to recognize the loss?	Sell property THEN then distribute the proceeds
E&P reduction in a qualifying redemption:	E&P is reduced by no more than the percentage of the corporation's stock redeemed (not the full redemption amount).
§331	
Complete liquidations	

Redemptions & Complete liquidations (cont)

Shareholders:	liquidating distribution = proceeds from sale of stock
	sale-or-exchange treatment // capital gain/loss
	Gain or loss = liquidating proceeds − stock basis
Corporation recognize:	gain or loss on assets distributed in liquidation
	treated as FMV on the date of distribution
	Losses ARE recognized in a complete liquidation
Exception:	loss limitation
	IF (distributed property) was acquired in a §351 transaction within 5 years && (distribution) to related party THEN loss may be disallowed or limited.
TLDR	
Regular (non-liquidating) distribution:	corpo = deemed sale, rec gain NOT loss
	Shareholder = dividend (ala w/i E&P)
Qualifying redemption:	shareholder = sale treatment
	corpo = deemed sale, rec gain NOT loss

Redemptions & Complete liquidations (cont)

Complete liquidation:	shareholder = sale treatment
	corpo = recognizes both gains AND losses

§199A

§199A allows noncorporate taxpayers to deduct up to 20% of qualified business income (QBI).	Available whether taxpayer itemizes or takes standard deduction
QBI deduction = lesser of:	(1) 20% × QBI
OR	20% × modified taxable income
MTI	taxable income - net capital gain
QBI	net ordinary income from a qualified trade or business conducted as a sole proprietorship, partnership, or S corporation.
QBI excludes:	capital gains/losses
	dividends
	interest income (unless properly allocable to the business)
	reasonable compensation paid to the owner, and guaranteed payments to partners
QBI is reduced by:	self-employment tax deduction [§164(f)]

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§199A (cont)

	self-employed health insurance [§162(l)]
	qualified retirement plan contributions [§404]
High-income limitations	For 2025: thresholds are $394,600 (MFJ) / $197,300 (single)
Above these, the deduction is limited to the GREATER of:	(a) 50% of W-2 wages paid by the business
	(b) 25% of W-2 wages + 2.5% of unadjusted basis of qualified property
	For specified service trade or business (SSTB — health, law, accounting, consulting, etc.): the QBI deduction phases out completely above the threshold.

If a taxpayer has a net qualified business loss across all businesses in a year, no QBI deduction is allowed and the loss carries forward to the next year to reduce QBI (but not below zero).

Example 46:
QBI from A = $20,000; Loss from B = ($50,000) Net = ($30,000) → No deduction, $30,000 carryforward
Next year: QBI $70,000 − $30,000 carryforward = $40,000 net QBI → deduction = $8,000

E&P

E&P =	the corporation's economic ability to pay dividends
Distribution treatment:	
First: Dividend income	E&P: current first, then accumulated
Second: Return of capital	reduces shareholder's stock basis
Third: Capital gain	when basis reaches zero
Allocating E&P:	
If current E&P is + && total distributions > current E&P	prorate current E&P
Current E&P to each distribution =	(That distribution / Total distributions) × Current E&P
Property distributions: corpo	
When Corpo distributes appreciated property:	deemed sale (recognize at FMV)
When Corpo distributes depreciated property:	Loss on distribution → NOT recognized
Shareholder receives:	dividend = FMV of property (to extent of E&P)
Shareholder's basis in property:	FMV at date of distribution
Corporation's E&P reduced by:	FMV of property (net of liabilities assumed by shareholder)

If current E&P is positive but accumulated E&P has a deficit: do NOT net them.

If accumulated E&P is positive but current E&P is a deficit: net both at the date of distribution

consolidated returns and affiliated groups

Affiliated group:	parent owns at least 80% of voting stock and value of all subsidiaries.
Consolidated return:	allows losses of one member to offset income of another.
	eliminates intercompany transactions
DRD in a consolidated group:	100% DRD applies to dividends
Built-in losses on assets	subject to §351 —losses that existed before joining the group can be limited.

Gain/Loss/Basis

(1) Taxable transaction	Realized = FVM - OG Basis
	Recognized = same
	New Basis = FMV
(2) Deferred	Realized = FVM - OG Basis
	Recognized = 0 (all deferred)
	New Basis = OG basis
(3) Deferred with boot	*FMV = OG basis - boot*
	Realized = FVM - OG Basis
	Recognized = Realized - Boot

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Gain/Loss/Basis (cont)

New Basis = FMV - Recognized

If there is a realized LOSS, boot NEVER triggers recognition in a deferred exchange. Deferred with boot : recognized = lesser of boot or realized gain

§368 Reorgs

§368	creates deferral
requirements:	(1) a written plan of reorganization
	(2) continuity of interest
	shareholders must retain equity in the acquiring corp
	(3) continuity of business enterprise
	(4) a sound business purpose
	(5) the step transaction doctrine must not apply
Types	
Type A: merger or consolidation	All-in-one
	-60% boot allowed
	-same tax attributes (NOL & E&P)
	shareholders = 40% voting stock
Type B: Stock-for-stock	Both Live
	-NO boot
	- parent /subsidiary
Type C: Stock-for-assets	Cull

§368 Reorgs (cont)

Type D: Divisive	Divide
Type E: Recapitalization	Exchange inside
Type F: Change in identity, form, or place	Face-lift
Type G: Bankruptcy	Gone broke
Boot in a §368	
If shareholders receive boot	they recognize gain up to the lesser of boot received or realized gain

Both the transferor corporation and the acquiring corporation recognize $0 gain or loss in a qualifying reorganization.

The gain is deferred into the new entity's basis and the shareholder's new stock basis.

M-1, CC, DRD

Schedule M-1	reconciling book income to taxable income
ADDITIONS:	+ Federal income tax per books
	+ Excess capital losses over capital gains
	+ Income reported for tax NOW but not in books (pre-paid)
	+ Expenses deducted in books but not for tax (excess charity)
SUBTRACTIONS:	− Income reported in books but excluded from tax (tax-exempt interest)

M-1, CC, DRD (cont)

	− Tax deductions not expensed in books (excess tax depreciation)
Result: taxable income before NOL and DRD.	
Charitable contributions	10% of taxable income // Excess contributions carry over 5 years
taxable income calc not affected by:	(1) the charitable contribution deduction itself
	(2) NOL or capital loss carrybacks
	(3) the DRD
Dividends received deduction (DRD)	
Ownership % → DRD %:	
Less than 20% →	50%
20%–79% →	65%
80% or more →	100%
Step 1:	Dividends received × DRD %
Step 2:	Taxable income (before DRD) × DRD %
Step 3:	Deduction = lesser of Step 1 or Step 2
EXCEPTION (NOL rule):	if using Step 1 creates an NOL, use Step 1 anyway.

M-1 items — proceeds are tax-free (subtract), premiums are non-deductible (add).

Accrual basis corporations: may deduct in the year preceding payment if the board authorized the contribution by year-end AND payment is made by the 15th day of the 4th month after year-end

Stock must be held more than 45 days to claim the DRD.

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