## 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 |



Sponsored by **CrosswordCheats.com**
Learn to solve cryptic crosswords!
http://crosswordcheats.com

| 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)] |



Sponsored by **CrosswordCheats.com**
Learn to solve cryptic crosswords!
http://crosswordcheats.com

## §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 |



Sponsored by **CrosswordCheats.com**
Learn to solve cryptic crosswords!
http://crosswordcheats.com

## 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: Recapital-ization | 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) |
| SUBTRA-CTIONS: | − 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 contri-bution 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 (subtr-act), 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.



Sponsored by **CrosswordCheats.com**
Learn to solve cryptic crosswords!
http://crosswordcheats.com