

Changes in S Corporation Stock Ownership

NATP™

Your Instructor

Objectives

- Explain how shareholders are taxed on the sale of their S corporation stock
- Summarize the tax consequences of an S corporation stock redemption
- Explain how S corporations allocate pass-through items when stock ownership changes
- Recognize when a change in stock ownership inadvertently terminates the S election



Methods of Disposition

- Sale
- Redemption
- Liquidating distribution
- Gift
- Transfer at death
- Taxable exchange
- Reorganization under §368
- Transfer to bankruptcy estate
- Collateral repossession



Sale of Stock

- Determine the adjusted basis of stock immediately before the disposition
- Start with stock basis at the beginning of the year
- Adjustments in the following order:
  - Increase by additional contributions to capital
  - Increase by income items and excess depletion
  - Decrease by distributions
  - Decrease by nondeductible, noncapital expenses and oil and gas depletion
  - Decrease by deductible loss and deduction items



Sale of Stock, Cont.

- Election under Reg. §1.1367-1(g) to prioritize deduction items
- Section 179 carryovers increase basis at disposition (Reg. §1.179-3(h))

Example

- Serena is a 15% shareholder in Mercury, Inc., an S corporation, in which she actively participates. Last year, Mercury passed through a §179 deduction of $25,000 to Serena. Serena reduced her stock basis by the full $25,000 §179 deduction; however, she could not deduct any of it because she also had a net loss from her sole proprietorship that zeroed out her taxable business income. Thus, Serena has a §179 carryover of the disallowed deduction on her personal income tax return.
- On Jan. 1 of the subsequent year, Serena sold all her S corporation stock to Whitney. When computing the gain or loss on the sale of Serena's stock, increase her stock basis immediately before the disposition by the unused §179 carryover of $25,000.

Tax Treatment

- Long-term if held > one year
- Taxed at 0%/15%/20% based on income thresholds



Example

- On Jan. 1, 2005, Regina Johnson was issued 100 shares in exchange for $200,000
- She sold all 100 shares on July 31, 2024, for $1.1 million
- Regina’s stock basis at the time of sale was $500,000, so she has a $600,000 ($1.1 million – $500,000) long-term capital gain on the sale of her stock

Example, Cont.

- Regina was a passive shareholder who did not provide any services to the S corporation
- Assume the S corporation had no income or losses for 2024, and Regina does not have any other income besides the capital gain from the sale of her stock
- If she claimed a standard deduction of $16,550 ($14,600 + $1,950 for age) on her 2024 tax return for a single filer (age 72), $583,450 ($600,000 – $16,550) of the capital gain is taxable

Example, Cont.

- A portion of Regina's capital gain is taxed at each capital gains tax rate
  - $47,025 is taxed at the 0% rate
  - $471,875 is taxed at the 15% rate
  - $64,550 is taxed at the 20% rate
- Regular tax using the capital gains tax rates is $83,691 ($70,781 + $12,910), which is significantly lower than $174,582 had the capital gain been taxed at ordinary income tax rates

Example, Cont. Qualified Dividends and Capital Gains Worksheet

Form 1040	Qualified Dividends and Capital Gain Tax Worksheet	2024

Name: Regina Johnson

Taxpayer Identification Number: ***-**-1111

1.	Enter the amount from Form 1040, 1040-SR, or 1040-NR, line 15. However, if you are filing Form 2555 (relating to foreign earned income), enter the amount from line 3 of the Foreign Earned Income Tax Worksheet	1.	583,450	
2.	Enter the amount from Form 1040, 1040-SR, or 1040-NR, line 3a*	2.		
3.	Are you filing Schedule D?* ☒ **Yes.** Enter the **smaller** of line 15 or 16 of Schedule D. If either line 15 or 16 is a loss, enter -0- ☐ **No.** Enter the amount from Form 1040, 1040-SR, or 1040-NR, line 7	3.	600,000	
4.	Add lines 2 and 3	4.	600,000	
5.	Subtract line 4 from line 1. If zero or less, enter -0-	5.	0	
6.	Enter: $47,025 if single or married filing separately, $94,050 if married filing jointly or qualifying surviving spouse, $63,000 if head of household.	6.	47,025	
7.	Enter the smaller of line 1 or line 6	7.	47,025	
8.	Enter the smaller of line 5 or line 7	8.	0	
9.	Subtract line 8 from line 7. This amount is taxed at 0%	9.	47,025	
10.	Enter the smaller of line 1 or line 4	10.	583,450	
11.	Enter the amount from line 9	11.	47,025	
12.	Subtract line 11 from line 10	12.	536,425	
13.	Enter: $518,900 if single, $291,850 if married filing separately, $583,750 if married filing jointly or qualifying surviving spouse, $551,350 if head of household.	13.	518,900	
14.	Enter the smaller of line 1 or line 13	14.	518,900	
15.	Add lines 5 and 9	15.	47,025	
16.	Subtract line 15 from line 14. If zero or less, enter -0-	16.	471,875	
17.	Enter the smaller of line 12 or line 16	17.	471,875	
18.	Multiply line 17 by 15% (0.15)			18. 70,781
19.	Add lines 9 and 17	19.	518,900	
20.	Subtract line 19 from line 10	20.	64,550	
21.	Multiply line 20 by 20% (0.20)			21. 12,910
22.	Figure the tax on the amount on line 5. If the amount on line 5 is less than $100,000, use the Tax Table to figure the tax. If the amount on line 5 is $100,000 or more, use the Tax Computation Worksheet			22. 0
23.	Add lines 18, 21, and 22			23. 83,691
24.	Figure the tax on the amount on line 1. If the amount on line 1 is less than $100,000, use the Tax Table to figure the tax. If the amount on line 1 is $100,000 or more, use the Tax Computation Worksheet			24. 174,582
25.	**Tax on all taxable income.** Enter the **smaller** of line 23 or line 24. Also include this amount on the entry space on Form 1040, 1040-SR, or 1040-NR, line 16. If you are filing Form 2555, do not enter this amount on the entry space on 1040, 1040-SR, or 1040-NR, line 16. Instead, enter it on line 4 of the Foreign Earned Income Tax Worksheet			25. 83,691

*If you are filing Form 2555, these lines may be reduced (but not below zero) by your capital gain excess. Please refer to Foreign Earned Income Tax Worksheets - Excess Capital Gain for detail if the lines have been reduced.

Capital Losses

- Capital losses offset gains
- Can deduct up to $3,000 annually
  - Excess carried forward
- Disallowed if sold to a related party (§267, §707)

Net Investment Income Tax (NIIT)

- 3.8% tax if MAGI exceeds threshold
- Applies unless shareholder materially participated and S corporation has no §1411 property (§1.1411-7)



Reporting – Seller

- Form 8949
- Schedule E (check box on Line, 28(e))
- Attach Form 7203
- NIIT reported on Form 8960
  - Line 5a
  - Line 5c if not subject to NIIT



Example

- On Jan. 1, 2005, Regina Johnson was issued 100 shares in exchange for $200,000
- She sold all 100 shares on July 31, 2024, for $1.1 million
- Regina's stock basis at the time of sale was $500,000, so she has a $600,000 ($1.1 million – $500,000) long-term capital gain
- Regina was a passive shareholder who did not provide any services to the S corporation
- Assume the S corporation had no income or losses for 2024

Example, Cont. – Form 8949

Form 8949 (2024) Attachment Sequence No. 12A Page 2

Name(s) shown on return. Name and SSN or taxpayer identification no. not required if shown on other side: Regina Johnson

Social security number or taxpayer identification number: ***-**-1111

Before you check Box D, E, or F below, see whether you received any Form(s) 1099-B or substitute statement(s) from your broker. A substitute statement will have the same information as Form 1099-B. Either will show whether your basis (usually your cost) was reported to the IRS by your broker and may even tell you which box to check.

Part II **Long-Term.** Transactions involving capital assets you held more than 1 year are generally long-term (see instructions). For short-term transactions, see page 1.
Note: You may aggregate all long-term transactions reported on Form(s) 1099-B showing basis was reported to the IRS and for which no adjustments or codes are required. Enter the totals directly on Schedule D, line 8a; you aren't required to report these transactions on Form 8949 (see instructions).

You *must* check Box D, E, *or* F below. Check only one box. If more than one box applies for your long-term transactions, complete a separate Form 8949, page 2, for each applicable box. If you have more long-term transactions than will fit on this page for one or more of the boxes, complete as many forms with the same box checked as you need.

- ☐ **(D)** Long-term transactions reported on Form(s) 1099-B showing basis was reported to the IRS (see **Note** above)
- ☐ **(E)** Long-term transactions reported on Form(s) 1099-B showing basis **wasn't** reported to the IRS
- ☒ **(F)** Long-term transactions not reported to you on Form 1099-B

1 (a) Description of property (Example: 100 sh. XYZ Co.)	(b) Date acquired (Mo., day, yr.)	(c) Date sold or disposed of (Mo., day, yr.)	(d) Proceeds (sales price) (see instructions)	(e) Cost or other basis See the **Note** below and see *Column (e)* in the separate instructions.	Adjustment, if any, to gain or loss If you enter an amount in column (g), enter a code in column (f). See the separate instructions. (f) Code(s) from instructions	(g) Amount of adjustment	(h) Gain or (loss) Subtract column (e) from column (d) and combine the result with column (g).
100 sh S corporation stock	01/01/05	07/31/24	1,100,000	500,000			600,000

Example, Cont. – Schedule E

Schedule E (Form 1040) 2024 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**

Regina Johnson | ***-**-1111

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 unallowed loss from a passive activity (if that loss was not reported on Form 8582), or unreimbursed partnership expenses? If 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 foreign partnership	**(d)** Employer identification number	**(e)** Check if basis computation is required	**(f)** Check if any amount is not at risk
A	S corporation	**S**		**-***4444	X	
B						
C						
D						

Form 7203

Form **7203**
(Rev. December 2022)
Department of the Treasury
Internal Revenue Service

S Corporation Shareholder Stock and Debt Basis Limitations

Attach to your tax return.
Go to *www.irs.gov/Form7203* for instructions and the latest information.

OMB No. 1545-2302

Attachment Sequence No. **203**

Name of shareholder: Regina Johnson
Identifying number: ***-**-1111

A Name of S corporation: S corporation
B Employer identification number: **-***4444

C Stock block (see instructions):

D Check applicable box(es) to indicate how stock was acquired:
(1) [X] Original shareholder (2) [ ] Purchased (3) [ ] Inherited (4) [ ] Gifted (5) [ ] Other:

E Check if you have a Regulations section 1.1367-1(g) election in effect during the tax year for this S corporation [ ]

Part I Shareholder Stock Basis

1	Stock basis at the beginning of the corporation's tax year		1	500,000
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	0
5	Stock basis before distributions. Add lines 1, 2, and 4		5	500,000
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 8949 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	500,000
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	500,000
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	500,000

Form 8960

Form **8960**

Department of the Treasury
Internal Revenue Service

Net Investment Income Tax—Individuals, Estates, and Trusts

Attach to your tax return.

Go to *www.irs.gov/Form8960* for instructions and the latest information.

OMB No. 1545-2227

2024

Attachment Sequence No. **72**

Name(s) shown on your tax return: Regina Johnson

Your social security number or EIN: ***-**-1111

Part I Investment Income

- ☐ Section 6013(g) election (see instructions)
- ☐ Section 6013(h) election (see instructions)
- ☐ Regulations section 1.1411-10(g) election (see instructions)

1	Taxable interest (see instructions)			1	
2	Ordinary dividends (see instructions)			2	
3	Annuities (see instructions)			3	
4a	Rental real estate, royalties, partnerships, S corporations, trusts, trades or businesses, etc. (see instructions)	4a			
b	Adjustment for net income or loss derived in the ordinary course of a non-section 1411 trade or business (see instructions)	4b			
c	Combine lines 4a and 4b			4c	
5a	Net gain or loss from disposition of property (see instructions)	5a	600,000		
b	Net gain or loss from disposition of property that is not subject to net investment income tax (see instructions)	5b			
c	Adjustment from disposition of partnership interest or S corporation stock (see instructions)	5c			
d	Combine lines 5a through 5c			5d	600,000
6	Adjustments to investment income for certain CFCs and PFICs (see instructions)			6	
7	Other modifications to investment income (see instructions)			7	
8	Total investment income. Combine lines 1, 2, 3, 4c, 5d, 6, and 7			8	600,000

Part II Investment Expenses Allocable to Investment Income and Modifications

9a	Investment interest expenses (see instructions)	9a			
b	State, local, and foreign income tax (see instructions)	9b			
c	Miscellaneous investment expenses (see instructions)	9c			
d	Add lines 9a, 9b, and 9c			9d	
10	Additional modifications (see instructions)			10	
11	Total deductions and modifications. Add lines 9d and 10			11	

Part III Tax Computation

12	Net investment income. Subtract Part II, line 11, from Part I, line 8. Individuals, complete lines 13-17. Estates and trusts, complete lines 18a–21. If zero or less, enter -0-			12	600,000
	Individuals:				
13	Modified adjusted gross income (see instructions)	13	600,000		
14	Threshold based on filing status (see instructions)	14	200,000		
15	Subtract line 14 from line 13. If zero or less, enter -0-	15	400,000		
16	Enter the smaller of line 12 or line 15			16	400,000
17	Net investment income tax for individuals. Multiply line 16 by 3.8% (0.038). **Enter here and include on your tax return** (see instructions)			17	15,200
	Estates and Trusts:				
18a	Net investment income (line 12 above)	18a			
b	Deductions for distributions of net investment income and charitable deductions (see instructions)	18b			
c	Undistributed net investment income. Subtract line 18b from line 18a (see instructions). If zero or less, enter -0-	18c			
19a	Adjusted gross income (see instructions)	19a			
b	Highest tax bracket for estates and trusts for the year (see instructions)	19b			
c	Subtract line 19b from line 19a. If zero or less, enter -0-	19c			
20	Enter the smaller of line 18c or line 19c			20	
21	Net investment income tax for estates and trusts. Multiply line 20 by 3.8% (0.038). **Enter here and include on your tax return** (see instructions)			21	

For Paperwork Reduction Act Notice, see your tax return instructions. Form **8960** (2024)

Reporting – Buyer

- Buyer only files Form 1099-B if acting as broker (§1.6045-1)
- File Form 8822-B within 60 days if the responsible party changes



Special Tax Provisions

- Section 1244 stock
- Look-through rules



Section 1244 Stock

- Ordinary loss deduction up to $50,000 ($100,000 MFJ)
- Requirements:
  - Must be an original shareholder
  - Corporation was a domestic small business corporation when stock was issued
  - Stock issued in exchange for money or property
  - >50% gross receipts from non-passive sources during five most recent tax years
- Additional basis (e.g., from contributions) allocated to non-§1244 stock
- Report on Form 4797



Example

- On Jan. 1, 2020, B&B, Inc. (an S corporation) issued 100 shares of §1244 stock to Xavier (filing as single) for $60,000
- Xavier sold this stock for $1,000 on Aug. 15, 2024, when his stock basis was $55,000
- Xavier has a $54,000 loss ($1,000 – $55,000) on the sale of his stock
- Xavier can claim $50,000 of this loss as an ordinary loss on Form 4797, Part II. The remaining $4,000 loss ($54,000 – $50,000) is a long-term capital loss on Form 8949.

Example, Cont. – Form 4797

Part II Ordinary Gains and Losses (see instructions)

10	Ordinary gains and losses not included on lines 11 through 16 (include property held 1 year or less):					
	Section 1244 Loss Limitation					
						4,000
	100.000 sh B&B, Inc.					
		01/01/20	08/15/24	1,000	55,000	-54,000
11	Loss, if any, from line 7				11	( )
12	Gain, if any, from line 7 or amount from line 8, if applicable				12	
13	Gain, if any, from line 31				13	
14	Net gain or (loss) from Form 4684, lines 31 and 38a				14	
15	Ordinary gain from installment sales from Form 6252, line 25 or 36				15	
16	Ordinary gain or (loss) from like-kind exchanges from Form 8824				16	
17	Combine lines 10 through 16				17	-50,000
18	For all except individual returns, enter the amount from line 17 on the appropriate line of your return and skip lines a and b below. For individual returns, complete lines a and b below.					
a	If the loss on line 11 includes a loss from Form 4684, line 35, column (b)(ii), enter that part of the loss here. Enter the loss from income-producing property on Schedule A (Form 1040), line 16. (Do not include any loss on property used as an employee.) Identify as from "Form 4797, line 18a." See instructions				18a	
b	Redetermine the gain or (loss) on line 17 excluding the loss, if any, on line 18a. Enter here and on Schedule 1 (Form 1040), Part I, line 4				18b	-50,000

For Paperwork Reduction Act Notice, see separate instructions. Form **4797** (2024)

Example, Cont. – Form 8949

Form 8949 (2024) Attachment Sequence No. **12A** Page **2**

Name(s) shown on return. Name and SSN or taxpayer identification no. not required if shown on other side: **Xavier**

Social security number or taxpayer identification number: ***-**-1111

Before you check Box D, E, or F below, see whether you received any Form(s) 1099-B or substitute statement(s) from your broker. A substitute statement will have the same information as Form 1099-B. Either will show whether your basis (usually your cost) was reported to the IRS by your broker and may even tell you which box to check.

Part II **Long-Term.** Transactions involving capital assets you held more than 1 year are generally long-term (see instructions). For short-term transactions, see page 1.

Note: You may aggregate all long-term transactions reported on Form(s) 1099-B showing basis was reported to the IRS and for which no adjustments or codes are required. Enter the totals directly on Schedule D, line 8a; you aren't required to report these transactions on Form 8949 (see instructions).

You *must* check Box D, E, *or* F below. Check only one box. If more than one box applies for your long-term transactions, complete a separate Form 8949, page 2, for each applicable box. If you have more long-term transactions than will fit on this page for one or more of the boxes, complete as many forms with the same box checked as you need.

- ☐ **(D)** Long-term transactions reported on Form(s) 1099-B showing basis was reported to the IRS (see **Note** above)
- ☐ **(E)** Long-term transactions reported on Form(s) 1099-B showing basis **wasn't** reported to the IRS
- ☒ **(F)** Long-term transactions not reported to you on Form 1099-B

1 (a) Description of property (Example: 100 sh. XYZ Co.)	(b) Date acquired (Mo., day, yr.)	(c) Date sold or disposed of (Mo., day, yr.)	(d) Proceeds (sales price) (see instructions)	(e) Cost or other basis See the **Note** below and see *Column (e)* in the separate instructions.	Adjustment, if any, to gain or loss If you enter an amount in column (g), enter a code in column (f). **See the separate instructions.** (f) Code(s) from instructions	(g) Amount of adjustment	(h) **Gain or (loss)** Subtract column (e) from column (d) and combine the result with column (g).
100.000 sh B&B, Inc.	01/01/20	08/15/24	1,000	55,000	S	50,000	-4,000

Look-through Rules

- Collectible gains
- Section 1254 recapture



Suspended Pass-Through Losses

- **Basis-limited:** lost permanently unless stock is transferred to spouse/divorce
- **At-risk:** gain on stock sale increases at-risk amount, potentially releasing losses
- **PALs:** deductible in year of full stock disposition to unrelated party; if gifted, increase recipient's basis [§469(j)(6)]
- **EBLs:** become NOL carryovers



Stock Redemption

- Occurs when S-corp obtains its own outstanding stock back from the shareholder
- Redeemed stock can be cancelled, retired or held as treasury stock
- Five statutory methods to qualify for a sale or exchange
- With terminations, must consider constructive stock ownership under §318(a)
  - Exceptions



S-Corp Tax Consequences

- No gain/loss if redeemed with cash/note (§311(a))
- If distribute property with FMV > basis → gain passed to shareholders (§311(b))
- BIG tax applies for built-in gains during five-year period



Shareholder Tax Consequences

- Sale or exchange treatment = Form 8949
- Otherwise, treat as a normal distribution
  - Tax treatment is based on whether there is AE&P



Reporting Requirements

- Generally S-corp does not issue a 1099-B
- Impacts Schedule M-2 if qualifies as a sale or exchange
- Nondividend distributions reported on Schedule K-1, Box 16, Code D
- Dividend distributions reported on Form 1099-DIV
- Schedule L



Example

- Action Adventures, Inc., an S corporation, has AAA of $12,000 and AE&P of $6,000 immediately before the redemption of its stock. Barry owns 85% and Gary owns 15% of the S corporation's100 outstanding shares. Action Adventures redeems all of Barry's stock for $15,000 when Barry's stock basis is $3,000.
- The redemption qualifies as a sale or exchange, so there is a prorated reduction of both AAA and AE&P. AAA is reduced to $1,800 [$12,000 - $10,200 ($12,000 x 85%)], and AE&P is reduced to $900 [$6,000 - $5,100 ($6,000 x 85%)]. Barry reports a capital gain of $12,000 ($15,000 - $3,000 basis) from the sale of his stock.

Example, Cont.

- Immediately before the redemption, Action Adventures had balances in its capital stock of $4,500 and additional paid-in capital of $6,000. The S corporation records the redemption on its books using either one of the following journal entries:

	Debit	Credit
Capital stock (85% x $4,500)	$3,825	
Additional paid-in capital (85% x $6,000)	$5,100	
Retained earnings (plug)	$6,075	
Cash		$15,000
-OR-		
Treasury stock	$15,000	
Cash		$15,000

Allocation of Income (Loss)

- Per-share, per-day basis
- Reflected on Schedule K-1, Items G and H
- If there is a change in ownership percentage, ownership is weighted



Example

- A and B each owned 50% of the stock in an S corporation for half the year. On June 30, A and B each sold 10% of their stock to C. Thus, for the remaining half of the year, A, B and C each held 40%, 40% and 20%, respectively.
- Figure the weighted percentage of ownership for the year for A, B and C as follows:

	a	b	c (a × b)	
	% of total stock owned	% of tax year held	% of ownership for the year	
A	50 40	50 50	25 +20	45
B	50 40	50 50	25 +20	45
C	20	50	10	10
Total				100%

Specific Accounting Election

- Treat year as two separate tax years
- Requires consent of affected shareholders and election statement with Form 1120-S



Example

- Jill, Gina, Heather and Diane each own 25% of the outstanding stock of HYER, Inc., an S corporation, on Jan. 1. No distributions were made during the year. Heather sold all her stock to Kathy on April 30. As of Dec. 31, the corporation shows income of $75,000. The net income of $75,000 consisted of a loss of $55,000 on April 30 and income of $130,000 for the remaining eight months.
- Whether the corporation uses the per-share, per-day method or the specific accounting method affects Heather and Kathy's pass-through income

Example, Cont.

Per-Share, Per-Day Method	
Jill (25% x 365/365) x 75,000	$18,750
Gina (25% x 365/365) x 75,000	18,750
Heather (25% x 120/365) x 75,000	6,164
Diane (25% x 365/365) x 75,000	18,750
Kathy (25% x 245/365) x 75,000	12,586
Total:	$75,000

Specific Accounting Method			
	1/1–4/30 $55,000 x 25%	5/1–12/31 $130,000 x 25%	Total
Jill	($13,750)	$32,500	$18,750
Gina	(13,750)	32,500	18,750
Heather	(13,750)	0	(13,750)
Diane	(13,750)	32,500	18,750
Kathy	0	32,500	32,500
Totals	($55,000)	$130,000	$75,000

Example, Cont.

- Under the per-share, per-day method, Heather recognizes income of $6,164, but under the specific accounting method she recognizes a loss of $13,750. Kathy recognizes income of $12,586 under the per-share, per-day method, but she recognizes income of $32,500 under the specific accounting method.
- Heather sold her stock to Kathy for $42,000. She had a basis of $26,000 at the beginning of the year. She received a salary of $30,000 for the four months that she was a shareholder.

Example, Cont.

Basis in Stock:	Per-Share Per-Day	Specific Accounting
Basis, beginning of year	$26,000	$26,000
Ordinary income pass-through	6,164	0
Basis before losses and deductions	32,164	26,000
Ordinary pass-through loss	0	(13,750)
Basis, end of year	$32,164	$12,250
Capital gains:		
Sales price of stock	$42,000	$42,000
Basis in stock at time of sale	32,164	12,250
Capital gain from sale	$ 9,836	$29,750
Total income from HYER, Inc:		
Wages	$30,000	$30,000
Pass-through income (loss)	6,164	(13,750)
Capital gain	9,836	29,750
Total	$46,000	$46,000

Example, Cont.

- In the end, Heather recognizes the same amount of income from HYER, Inc. under both allocation methods. However, 65% ($29,750/$46,000) of the income is taxed at the capital gains rates using the specific accounting method. Alternately, only 21% ($9,836/$46,000) of the income is taxed at the capital gains rates using the per-share, per-day method with 79% taxed at ordinary income tax rates.
- The aggregate income might end up being the same for the selling shareholder no matter which method is used. However, as the example above illustrates, the tax consequences might be very different.

Specific Accounting Election

- Available when there is a qualifying disposition of stock
- Death



Inadvertent Termination of S Election

- Disqualifying events
  - More than 100 shareholders
  - Ineligible shareholder
  - Nonresident alien shareholder
- Reporting
- Waiver



THANK YOU

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