

September 16, 2021

Kinna Brewington
Internal Revenue Service, Room 6526
1111 Constitution Avenue NW
Washington, DC 20224

***also sent via email to
Kinna.Brewington@IRS.gov***

Re: Comment Request for form 7203
Title: S Corporation Shareholder Stock and Debt Basis Limitations
OMB Number: 1545-XXXX

Dear Kinna Brewington,

On behalf of the National Tax Office of Wipfli, LLP (a top-20 CPA firm in the United States), I appreciate the opportunity to submit the following comments to the Internal Revenue Service regarding proposed the January 13, 2021 draft of new form 7203, S Corporation Shareholder Stock and Debt Basis Limitations.

You have specifically invited comments with respect to (a) whether the collection of information is necessary for the proper performance of the functions of the IRS; (b) the accuracy of the agency's estimate of the burden of the collection of information; (c) ways to enhance the quality, utility, and clarity of the information to be collected requested; and (d) ways to minimize the burden of the collection of information on respondents.

We believe our comments address most of those concerns and also includes suggestions to make the form more useful and effective for the IRS, for taxpayers, and for practitioners when basis determinations may be critical though not related to loss limitations or whether loan repayments are wholly or partially taxable.

Whether the collection of information is necessary for the proper performance of the functions of the agency, including whether the information shall have practical utility;

1. The instructions under **Who Must File** do not currently include shareholders who received loan repayments during the year. For the past 30 or so years the instructions to form 1040, Schedule E, included loan repayments as a condition for the required attachment of a basis calculation. In light of the purpose of this new form, we suggest it be required whenever loan repayments have been made.
2. **Whenever tax preferences exist** during the period of S Corporation stock ownership, the taxpayer's stock (and possibly debt) basis will differ for AMT purposes. In the interest of additional accuracy and completeness, consider adding a reminder in the instructions that a separate calculation needs to be maintained for AMT purposes. Taxpayers should be tracking AMT basis in any event, so the additional form should not be an undue burden (with the possible exception of taxpayers preparing their returns manually). There are several other circumstances where separate AMT calculations

are needed (and are best performed on a second version of the form), but actually filing the AMT version of those forms is not required. Consider being consistent and not mandating filing the AMT version form 7203 even though many 1040 software programs will likely prepare an AMT version of the form.

3. S Corporations of any substance will likely have distributions, shareholder loan repayments, or aggregate losses in most years. Shareholders need to track basis in any event. Consider suggesting in the instructions that it is **prudent to complete and retain the form even in years for which it is not required to be filed**. Retaining copies of the form for years it is not required will help make the basis calcs more transparent and more readily auditable by the IRS while also serving as a reminder that the taxpayer has an ongoing burden to track basis.
4. Under “**Part I. Shareholder Stock Basis**” the instructions state that the basis of inherited property is generally the FMV at DOD. Consider adding clarifying language to the effect that it is the INITIAL basis of inherited property that is generally FMV at DOD and that such basis needs to be adjusted for activity from DOD through the effective date the shares are actually transferred to you in order to determine your initial basis, then from that date through the current year in order to determine your basis at year-end.
5. The specific instructions for line 2 **with respect to basis of stock acquired by gift** reference Reg. §1.1015-1 if the FMV was less than the donor’s basis. It would be prudent to also reference Reg. §1.1366-2(a)(6) which specifically limits losses to the lower amount. Furthermore, in light of the overall purpose of the form, consider making it clear that for purposes of completing form 7203 the taxpayer is to use the lesser of the donor’s basis or FMV at date of gift for the initial basis. This would also be an ideal place to add an optional information line reflecting the excess of donor’s basis over FMV. Although it is not a stated purpose for this form, it will be useful information for the taxpayer and the IRS in the year of sale, as this information could be critical in determining gain on sale or liquidation, which may be decades after receipt of the gift. A best practice would be to ensure the information is tracked as early as possible. Similar information would be appropriate if the taxpayer purchased the stock or debt from a related party at a time when the property’s FMV was less than the seller’s basis.
6. In order to be more precise, consider changing the second sentence of the instructions for Part 1, line 6 to “Do not include **distributions of C Corporation Earnings and Profits** that are reportable on form 1099-DIV.
7. Consider adding lines to reflect a reduction for the basis of stock and/or of debt disposed **of by sale or exchange or by gift**.
8. Consider including in the specific instructions for line 17 that it includes the **face value of loans received by gift or inheritance** in addition current year loans made by the taxpayer.
9. Consider including in the specific instructions for line 22 that **if the FMV of loans received by gift or inheritance during the year is less than face value**, line 22 should not include the excess of face over FMV.
10. In Part II of form 7203 the taxpayer is to indicate **whether each loan is documented with a formal note or whether it is open account debt**. Under Reg. §1.1367-2(a)(2)(ii) when open account debt

increases by at least \$25,000 during the year it is to be classified as a formal note as of the beginning of the next year for purposes of the debt basis calculations. The Service may want to consider a separate box to indicate such 'deemed' formal notes to distinguish them from actual formal notes. Then the instructions for line 34 can more specifically reference that gain on repayment of open account debt as well as on deemed formal notes is ordinary, while gain on actual formal notes is capital.

Ways to enhance the quality, utility, and clarity of the information to be collected;

1. There are several references to **increasing or decreasing basis by the amounts "reported on Schedule K-1"**. Although that will most often be the case, there will be instances where the K-1 is in error (such as failure to show loan repayments or reflecting incorrect non-deductible expense amounts) or when the taxpayer takes an inconsistent position (and files an 8802) or when the 1040 needs to be filed prior to receipt of a late K-1. If you use the term 'reportable' on the K-1 rather than 'reported', we believe you'll cover those instances.
2. Under 'Limitations on Losses, Deductions, and Credits' you reference **at-risk, passive activity, and excess business loss limitations**. Consider including references to the related forms on which those limitations are calculated. That could be tremendous help to less experienced tax return preparers.
3. Under '**Basis Limitations**', **item 1**, consider stating that for years in which you are required to file a return you can only increase basis for income items to the extent that were actually reported on the return.
4. Under '**Basis Limitations**', **item 4**, consider stating that reportable losses and deductions decrease basis (but not below zero) whether or not the losses are claimed on your tax return
5. **Consider adding a box to check if the taxpayer is currently making, or has ever made, a 1.1367-1(g) election.** Doing so would help to highlight the importance of knowing whether an election was made and should help future preparers that may not have been involved in the year the election was made.
6. Although not relevant for the purposes of this form, consider explicitly stating in the instructions that **separate basis calculations for each block of stock may be critical for other purposes** (such as gain or loss on sale, or basis to the donee for gifted shares), but are not individually relevant with respect to the aggregate stock and debt basis limitations – and for that reason separate 7203s are not required for each block of stock.
7. Under "Basis of Loans" the instructions specify that Distributions do not reduce loan basis. In the interest of completeness and clarity, you may also want to state that **loan repayments do not decrease stock basis.**
8. Related to the above, **additional capital contributions do not increase loan basis.** In light of the fact that for several years the 1040 Schedule E instructions included a basis calculation that would have increased loan basis for capital contributions, we would urge you to specifically state that they do not.

9. In the first paragraph under Specific Instructions, you state that **taxpayer's MAY file more than one 7203** when there is a sale of some shares during the year, and the last paragraph of Part I of that section specifically DIRECTS the taxpayer to file two separate forms. This inconsistency should be rectified. In addition, it is not clear whether you are contemplating one 7203 for the block of shares sold and a separate 7203 for the shares retained, or whether you want one form for all shares for the period up to the date of sale and a separate form for the rest of the year, or whether the taxpayer is free to handle it any way they choose.
10. Consider using two or more columns on form 7203 (plus a total column) in order to use the form to **allow tracking of basis in different blocks of stock** even though the separate basis calculations are not needed for purposes of basis limitations, they may be needed for other purposes.
11. Consider adding a statement to the instructions to the effect that the taxpayer should **retain all K-1s and any other documentation supporting the information reflected on form 7203** at least until the statute of limitations runs on the last tax year in which taxpayer owned stock in the corporation, and that such information may also be required by anyone that received shares by gift
12. In the event that gains from non-dividend distributions in excess of basis in prior years were not reflected in taxable income, the IRS position is that the **unreported income is essentially kept in suspense** to reduce basis in the future (or potentially create phantom gain upon sale). Is that something you would want to reference in the instructions? You could also suggest filing an amended return if the error was in an open year.
13. Part III of form 7203 contemplates the **segregation of line-by-line allowable losses** from stock basis (column (c)) from the line-by-line allowable losses from debt basis (column (d)). The extent to which the loss is allowed because you have basis in stock or because you have basis in debt is not relevant and would not flow anywhere else within the return. Of course, it is important to know the total amount of each type of allowable loss or deduction. We suggest changing column (c) to be the total 'available' losses and deductions (the sum of columns (a) and (b)). Then column (d) could be the tentatively allowable loss (tentative because the at-risk, passive activity, and excess business loss limitations have yet to be applied). The tentatively allowable loss for each line would then either flow directly to the appropriate line on the return or to the supporting workpapers for the other limitations. Column (e) would continue to reflect carryover amounts.
14. In Part III of form 7203, consider adding a **separate line for non-deductible expenses** since those items are afforded different treatment than deductible expenses.

There will undoubtedly be some taxpayers and return preparers that have not been tracking basis and will want to use this form to determine basis as of the beginning of 2021. For the benefit of those that choose to do so (and also for the benefit of an IRS agent auditing the basis calculation) consider adding a few caveats dealing with changes to the basis calculation over the years. Failure to include this information could lead a user to a false sense of security.

1. The methodology for determining basis in S Corporation stock and debt differed substantially **prior to January 1, 1983** (the effective date of the S Corporation Revision Act) and basis changes for those years need to be determined based on the law in effect at that time

2. For **years beginning before 1997** basis was reduced by losses and deductions prior to reduction for distributions, and form 7203 is designed to reduce basis for distributions first.
3. The specific instructions for line 3k state that basis is not increased by excluded COD income. Taxpayers should be warned that basis was increased for excluded COD on debt discharges **prior to October 12, 2001**
4. Open account debt with respect to loans made **before October 17, 2008** were not subject to the requirement to treat net increases in open account debt of \$25,000 or more as a separate loan for purposes of the debt basis rules.
5. Consider adding specific instructions for line 42 to indicate that in the event the charitable contribution deduction includes appreciated property, you should generally only include your share of the corporation's basis in the donated property on that line. But in the case of charitable gifts of appreciated property made in **taxable years beginning before 2006**, you generally reduce basis for an amount equal to the charitable contribution deduction, which for certain contributions may be the fair market value of contributed property rather than its basis.

Once again, we want to thank the Internal Revenue Service for allowing the submission of comments on new form 7203. The January 13, 2021 draft version of the form is a significant improvement on the basis calculation schedules previously provided by the IRS. With the changes suggested above, the form can become even more efficient, accurate, and useful for the Service, for taxpayers, and for practitioners.

I would be happy to discuss any of this material with you. I can be reached via email at rsalter@wipfli.com or by phone at 847.562.4605.

Sincerely,

A handwritten signature in black ink that reads "Richard J. Salter". The signature is written in a cursive, flowing style.

Richard J. Salter CPA, JD, LLM
Partner