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September 16, 2021

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

Submitted via email and mail.

Title: S Corporation Shareholder Stock and Debt Basis Limitations.

OMB Number: 1545-XXXX.

Form Number: 7203

Dear Ms. Brewington:

Grant Thornton LLP appreciates the opportunity to comment on proposed Form 7203, *S Corporation Shareholder Stock and Debt Basis Limitations*.

Grant Thornton LLP is a leading global accounting, tax and business advisory firm. We are particularly focused on serving the needs of middle-market companies -- companies with annual revenues ranging from a few million to billions of dollars. Many S corporations and their shareholders naturally fall within this demographic.

We support the efforts of the Treasury Department ("Treasury") and the Internal Revenue Service ("the Service") to improve the quality of tax advice, tax services and tax reporting. We acknowledge the Service's responsiveness and attention to address concerns raised by stakeholders with respect to S corporation shareholder basis, including the efforts to date on published educational materials and outreach with industry stakeholders.

While we support the form and its need in the taxpayer community, the instructions appear confusing on who must file the form in consideration of past requirements.

Current Instruction Reporting Requirements

Form 1040, Schedule E, Part II currently provides that the basis computation is required:

If you are claiming a deduction for your share of an aggregate loss (or you receive a distribution, dispose of stock, or receive a loan repayment from an S corporation), check the box on the appropriate line in Part II, column (e), and attach to your return a computation of the adjusted basis of your corporate stock and of any debt the corporation owes you. For details, see the Shareholder's Instructions for Schedule K-1 (Form 1120-S).

These instructions list all of the times in which it is necessary to compute shareholder basis to determine if the shareholder may be subject to the limitation.

Proposed Form Instruction Reporting Requirements

The Form 7203 Instructions provide different instructions on who must file:

Who Must File

Form 7203 is filed by S corporation shareholders who receive non-dividend distributions, claim losses, deductions, and credits (including prior year losses, deductions, and credits) based on their stock and debt basis of the S corporation.

Several items require clarity on when to file the form including if the form is required when there is an aggregate loss versus any loss, when stock is disposed, and when the shareholder receives a loan repayment.

I. Aggregate loss versus any loss, deduction and credit (including prior year losses, deductions and credits)

Section 1366(d) limits the amount of loss and deduction items to the shareholder's stock and debt basis. Treasury Regulation § 1.1366-2(a)(5) provides an allocation rule if the aggregate loss and deduction items exceed the stock and debt basis. Treasury Regulation § 1.1366-2(a)(3) provides that the aggregate loss and deductions items that exceed the sum of the shareholder's stock and debt basis is not allowed for the current year, but rather is carried forward and is treated as incurred by the corporation in the corporation's first succeeding taxable year, and subsequent taxable years, with respect to the shareholder.

There is no need to determine the stock and debt basis in a year if the loss and deduction items are less than the S corporation's income for the year and the basis computation was properly carried forward from prior years. [This assumes there were no distributions, dispositions of stock, or loan repayments.] There is no need to determine basis as the current year income will exceed the shareholder's loss and deduction items and thus there cannot be a stock or debt basis limitation for the year. This position harms taxpayers by requiring them to spend time and money for the preparation of a form that has no benefit or increased compliance for the Service.

If the shareholder failed to report the basis computation in an earlier year, then the Service may request a copy of the shareholder's stock and debt basis limitation for almost any prior year so long as the loss and deduction items exceeded the corporation's income and there was a reporting requirement. The requirement to report basis only if there is an aggregate loss has been consistently included in the Instructions for Schedule E (Form 1040) since at least 1997 thus eliminating almost all situations where the Service is limited in its ability to request prior year basis computations without triggering an examination. The request for the basis computation will not trigger an examination of the earlier year as the shareholder was required to report the basis computation and will be considered a perfection of the return.

Expanding the current form instructions to require the basis computation for any year a loss or deduction item is reported is unnecessary and inconsistent with the reporting requirement of the last 20+ years. It will also increase costs for taxpayers to prepare their returns with no potential for increased compliance. We recommend the Service maintain the current reporting requirement as provided in the Instructions for Schedule E (Form 1040) with respect to aggregate loss and deduction items.

II. Disposition of stock

The requirement to report basis when stock is disposed was first added to the Instructions for Schedule E (Form 1040) in 2019 when the new checkbox to indicate the basis computation attachment was added.

The draft instructions for Form 7203 do not require the reporting of stock or debt basis when stock is disposed. The sale or disposition of stock through sale or gift can materially affect the shareholder's current or future returns. There are other situations such as worthless stock loss or liquidation of the S corporation where the basis in S corporation stock is necessary to know in order to properly prepare the shareholder's return.

While the term “dispose of stock” is not necessarily a defined term in the IRC, it is likely a reference to IRC § 1001 which requires the reporting of gain or loss upon the “sale or other disposition of property.” Alternatively, it could be in reference to the definition in IRC § 904(f)(3)(B) which defines a “disposition” as “a sale, exchange, distribution, or gift of property whether or not gain or loss is recognized on the transfer.”¹ It is unclear if the intent of the IRS is to identify events that materially impact the basis computation or merely events that trigger gain recognition; clarity in the instructions is helpful in preparing returns and avoiding exams through compliant disclosure.

We recommend, with respect to stock dispositions, the Service clarify the reporting requirement be consistent with the definition in IRC § 904(f)(3)(B) to require reporting of shareholder basis any time there is a change in the basis computation that does not arise out of the income, loss, deduction, distribution or credit items reflected on Schedule K-1 and to specifically include the basis computation when there is a sale, exchange, distribution, or gift that affects the basis computation whether or not gain or loss is recognized on the transfer.

If the Service does not expand the current draft instructions to include dispositions of stock, then this may lead to less compliance and audits of taxpayers that are otherwise properly considering the impact upon the stock and debt basis limitation. Audits are expensive both for taxpayers and the IRS, therefore providing clarity in when the form is required with specificity will in the long run decrease costs for many taxpayers and increase the IRS’ ability to identify non-compliance.

III. Receipt of a loan repayment

A shareholder in an S corporation is required to report a gain on loan repayment upon receipt of a loan payment when the loan has reduced basis debt. The only way to determine if a gain on loan repayment is required is to compute the shareholder’s stock and debt basis. Loan repayments are required to be reported on Schedule K-1, Box 16, Code E and the addition of beginning and end of year loan balances on Schedule K-1, Line H indicate the Service intends to more closely monitor debt basis and consequently gain on loan repayment.

Under the proposed form instructions, shareholders will no longer be required to report their basis computation when they have a loan repayment. We recommend the instructions maintain the requirement to report the shareholder’s basis any time the shareholder receives a loan repayment from an S corporation.

If the Service does not expand the current draft instructions to include reporting when there is a loan repayment, then this may lead to less compliance through inconsistent basis reporting and the failure to recognize gain on loan repayment of reduced basis debt. Once again audits are expensive both for taxpayers and the IRS, therefore providing clarity in when the form is required with specificity will in the long run decrease costs for many taxpayers and increase the IRS’ ability to identify non-compliance.

We would be pleased to discuss our comments with you. If you have any questions, please contact Jeff Alberty, Managing Director (jeff.alberty@us.gt.com).

Sincerely,

/s/ Grant Thornton LLP

¹ IRC § 904(f)(3)(B) is not a generally applicable term to define disposition since it is limited to the context of IRC § 904(f)(3) related to the limitation on foreign tax credits.