

To: Internal Revenue Service

From: Richard J. Salter CPA, JD, LLM  
National Tax Office

Date: May 24, 2022

Re: Form 7203 comments

We would like to acknowledge and thank you for the thoughtful consideration that you gave to the comments on the original draft of form 7203 that we provided to you on September 16, 2021. We appreciate that a number of our recommended changes were made, and that quite a few others were taken under advisement for consideration in future updates to the form and/or instructions.

Treasury chose not to modify the instructions regarding other suggestions that it considered “basic information that an advisor should already be aware of or that will become self-evident depending on the facts and circumstances.”

Several of the ‘basic information’ items are not necessarily generally known among the community of return preparers (notably relatively inexperienced preparers), or especially to taxpayers that prepare their own returns and that would place more reliance on the instructions. We continue to believe all of those suggested changes would make the form and the instructions more useful and effective for the IRS, for taxpayers, and for practitioners, while lessening the risk of errors. We note that a significant percentage of the existing instructions could also be considered as being ‘basic information that an advisor should already be aware of’.

The balance of this memorandum includes new suggestions as well as reiterations (with additional commentary) of some items previously deemed to be ‘basic information’ and encourage you to consider them for upcoming changes to the form and instructions.

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

1. There are a number of references in the instructions to **increasing or decreasing basis by the amounts reported on Schedule K-1**. This language could reasonably be interpreted as direction to use the K-1 amounts even if the taxpayer or preparer knows that information to be incorrect. For example, it is not uncommon for a K-1 to erroneously leave the line for shareholder loan repayments blank, or to improperly include depreciation or other timing differences as non-deductible expenses. There may be other items on the K-1 for which the taxpayer takes an inconsistent position that is, ideally, reflected on form 8802. In situations such as these, if the taxpayer or other return preparer follows the specific language of the current instructions by increasing or decreasing basis by the amounts actually reported on the K-1 (instead of the correct information they are reporting elsewhere on the return), it will result in an incorrect basis calculation. Changing the instructions to state that basis is

increased or decreased by the amounts reportable on the K-1 it would seem to resolve this potential issue.

2. Under **Basis of loans**, the instructions explicitly state that 'Distributions don't reduce loan basis'. The instructions do not explicitly state that loan repayments do not reduce stock basis. I concur with your comment that the latter is basic information that an advisor should be aware of. Failure to include the basic statement regarding loan repayments while including the closely related basic statement regarding distributions may cause some to conclude that treatment differs and that loan repayments can be applied reduce stock basis. We suggest that this inconsistency be resolved either including or excluding both statements.
3. We have previously suggested that you include a statement to the effect that **additional capital contributions do not increase loan basis**. Although we concur with your conclusion that this is basic information that an advisor should already be aware of, we continue to believe that the instructions should be clarified by including the statement. We would conclude that this would have been considered as 'basic information' for at least the last 40 years. The primary reason for our suggestion is that for many years (most recently 2016) the 1120-S Schedule K-1 instructions included a basis calculation worksheet that provided a different result. A copy of the 2016 worksheet is attached. If a taxpayer with reduced basis debt made a capital contribution during the year, following the clear and unambiguous language on line 8(b) of the worksheet results in that capital contribution (as well as stock basis at the beginning of the year, if any) being utilized to improperly increase debt basis rather than stock basis.
4. In cases where prior year(s) gains from non-dividend distributions in excess of basis were not reflected in taxable income or losses in excess of basis were claimed, the IRS position is that the **unreported income/excess loss is essentially kept in suspense** to reduce basis in the future or, potentially, create phantom gain upon sale. This position has the same tax consequence as treating that stock as though it had negative tax basis. Primarily due to that essential equivalence, we believe this is not a 'basic item' and that the instructions should reference this 'suspense' item. Excluding it from the instructions potentially increases the odds that this 'suspended' income is never reported.
5. This **suggestion is probably more appropriate for the team that works on the 1120-S Schedule K-1**, but we note that Box 16, code E requires disclosure of the principal amount of loan repayments made to the shareholder during the year. For purposes of tracking debt basis and proper preparation of form 7203, it would be most helpful if the K-1 also included disclosure the principal amount of loans the shareholder made to the corporation during the year.
6. The instructions for Part III currently state that column (a) should be the amount of the loss and deduction items as reported on your Schedule K-1. We suggest adding a TIP with respect to **Charitable Contributions of appreciated property**, for which the amount on line 42 should be the shareholders pro-rata share of the corporation's basis in such property (IRC §1367(a)(2)) even though the shareholder's deduction would include the pro-rata share of the appreciation in that property.
7. Finally, we have a suggestion that likely requires regulatory changes rather than just changes to the form. We note that a taxpayer's election under **Reg. §1.1367-1(g) to use the Elective Ordering Rule to reduce basis for deductible items before non-deductible expenses is essentially an irrevocable election**. Neither the Schedule E instructions, IRS Publications, or

scholarly articles on the topic focused on the negative aspects of the election until about 11 years ago – well after the effective date. Additionally, most tax preparation software did not account for this until a few years later. In order to satisfy the burden of proof that the election was never made, a taxpayer would presumably be required to provide copies of their entire personal income tax return for each and every year that they owned stock in that S Corporation (post 1982) and the Agent would then presumably need to peruse all of them looking for the election. That could be a daunting task, especially for returns that are hundreds of pages long. According to the Regulations the election is effective for all future years unless the shareholder receives the permission of the Commissioner. I would like to suggest that the IRS consider automatically allowing a revocation of the election after a certain number of years (three years would be ideal from a recordkeeping and return production standpoint, but I understand a longer period may be more consistent with Congressional intent). The election or the revocation could be made simply by checking a box on the 7203. Taxpayers that aren't sure whether they ever made the election or not could then make a protective revocation, which presumably then could not be reversed for a to-be-determined number of years. This approach would limit the number of years of returns that need to be retained and provided for this purpose. I have no way of even speculating as to the overall consequences from a tax collections standpoint, this suggestion is primarily focused on ease of administration.

We thank you for the opportunity to provide these suggestions and comments. I can be reached via email at [rsalter@wipfli.com](mailto:rsalter@wipfli.com) or by phone at 847.562.4605 if you would like to discuss any of this material.

## Worksheet for Figuring a Shareholder's Stock Basis

Keep for Your Records



1. Your stock basis at the beginning of the year ..... 1. \_\_\_\_\_
- Increases:**
2. Money and your adjusted basis in property contributed to the corporation ..... 2. \_\_\_\_\_
3. Your share of the corporation's income (including tax-exempt income) reduced by any amount included in income with respect to clean renewable energy or (for bonds issued before October 4, 2008) qualified zone academy bonds ..... 3. \_\_\_\_\_
4. Other increases to basis, including your share of the excess of the deductions for depletion (other than oil and gas depletion) over the basis of the property subject to depletion ..... 4. \_\_\_\_\_
- Decreases:**
5. Distributions of money and the fair market value of property (excluding dividend distributions reportable on Form 1099-DIV and distributions in excess of basis (the sum of lines 1 through 4)) ..... 5. ( \_\_\_\_\_ )
6. Enter **(a)** your share of the corporation's nondeductible expenses and the depletion deduction for any oil and gas property held by the corporation (but only to the extent your share of the property's adjusted basis exceeds the depletion deduction); **or (b)** if the election under Regulations section 1.1367-1(g) applies, your share of the corporation's deductions and losses (include your entire share of the section 179 expense deduction even if your allowable section 179 expense deduction is smaller) adjusted, if the corporation made a charitable contribution of property as described in (4) under [Basis Rules](#) ..... 6. ( \_\_\_\_\_ )
7. If the election under Regulations section 1.1367-1(g) applies, enter the amount from 6(a) above. Otherwise, enter the amount from 6(b) ..... 7. ( \_\_\_\_\_ )
8. Enter the smaller of **(a)** the excess, as of the beginning of the tax year, of the amount you are owed for loans you made to the corporation over your basis in those loans; **or (b)** the sum of lines 1 through 7. This amount increases your loan basis ..... 8. ( \_\_\_\_\_ )
9. Your stock basis in the corporation at the end of the year. Combine lines 1 through 8 ..... 9. \_\_\_\_\_