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LIST OF SUBSTANTIVE CHANGES AND ADDITIONS

PPC's 1120S Deskbook

Twenty-third Edition (October 2013)

The following are some of the important update features of the 2013 edition of *PPC's 1120S Deskbook*.

- **Simplified Procedures for Relief for Late Elections.** In August 2013, the IRS provided a new revenue procedure consolidating and simplifying the procedures for obtaining relief for late S and QSub elections, qualified Subchapter S trust (QSST) elections, and electing small business trust (ESBT) elections. The new procedures have been explained and flowcharts for obtaining relief have been included.
- **Ownership of S Stock by Same-sex Couples.** The effect of the Supreme Court's recent decision on the Defense of Marriage Act (DOMA) and its impact on same-sex couples has been explained as it relates to the election of S status, the ownership of stock in S corporations, and the related party rules that apply to S corporations and their shareholders.
- **Built-in Gains.** The onerous built-in gains tax is suspended for certain built-in gains recognized in 2013. An updated built-in gains tax worksheet is provided, and updated discussion explains how built-in gains that are exempt from corporate tax during the suspension period are reported on Form 1120S.
- **New 3.8% Net Investment Income Tax.** The new 3.8% net investment income tax (NIIT) can potentially affect individuals, trusts, and estates with income exceeding a certain amount. Several chapters explain how the NIIT applies to dispositions of S corporation stock, distributions from S corporations, and gross income or net gain from passive S corporation business activities.
- **Additional 0.9% Medicare Tax.** Starting in 2013, an additional 0.9% Medicare tax can potentially affect individuals with income over certain thresholds. Discussions have been added throughout the *Deskbook* addressing how this tax can potentially apply to S corporation shareholders.
- **Tangible Property Regulations.** In September 2013, the IRS released final and repropounded regulations providing guidance on the capitalization of certain tangible property costs. The *Deskbook* has been updated for these regulations, since they can be used, along with the prior temporary regulations, in preparing 2013 S corporation returns.

In addition to these featured items, your *Deskbook* also includes the following update items:

<u>Chapter</u>	<u>Substantive Changes and Additions</u>	<u>Reference</u>
Chapter 1 Eligibility	1. Discussion of a new revenue procedure consolidating and simplifying the procedures for obtaining relief for a late qualified Subchapter S trust (QSST) election and electing small business trust (ESBT) election has been added.	Key Issue 1B
	2. Covered how an electing small business trust (ESBT) calculates the new net investment income tax (NIIT).	Key Issue 1B

<u>Chapter</u>	<u>Substantive Changes and Additions</u>	<u>Reference</u>
	3. Explained how repeal of the Defense of Marriage Act affects counting family members for purposes of the 100-shareholder limit.	Key Issue 1C
	4. New discussion and examples show how the 3.8% net investment income tax can apply to pass-through income from an S corporation.	Key Issue 1J
	5. New discussion covers how wages and self-employment income are affected by the new 0.9% additional Medicare tax on earned income.	Key Issue 1K
	6. S corporations that must attach new Schedule B-1 to Form 1120S are identified and the information to be entered on the form is explained.	Key Issue 1L
Chapter 2 Filing and Repairing the S Election	1. The discussion has been expanded to cover how filing the S election (Form 2553) is affected by the Supreme Court's decision that Section 3 of the Defense of Marriage Act (DOMA) is unconstitutional.	Key Issue 2A
	2. This edition discusses how the "timely mailing as timely filing/paying" and <i>prima facie</i> evidence of delivery rules apply to sending an S election by private delivery service.	Key Issue 2A
	3. An example has been expanded to illustrate why it can be advantageous for a fiscal year C corporation to change to a calendar year before electing S status.	Key Issue 2B
	4. The new simplified IRS procedure for requesting and obtaining relief for a late or invalid S election is covered in this edition.	Key Issue 2C
Chapter 3 Incorporation and Capitalization	1. Explained how to make the election to apply the limitation on a transferred built-in loss to the transferor's basis.	Key Issue 3D
Chapter 5 Hidden Traps	1. The discussion has been updated for the release of final regulations on the capitalization of tangible assets.	Key Issue 5I
	2. A new key issue reviews the significant ways in which the new net investment income tax will affect S corporation shareholders beginning in 2013.	Key Issue 5M
	3. The tax implications of the <i>Windsor</i> decision holding that Section 3 of the Defense of Marriage Act (DOMA) is unconstitutional are discussed in a new key issue.	Key Issue 5N
Chapter 6 Trade or Business Income	1. Recent guidance concerning the deferral of gift card sales income is discussed.	Key Issue 6B
Chapter 7 Cost of Goods Sold	1. The discussion of capitalizing or expensing tangible property, including materials and supplies and rotatable spare parts, under the IRS final tangible property regulations has been revised and expanded.	Key Issue 7A
	2. Expanded discussion regarding alternate inventory valuation methods for certain businesses is included.	Key Issue 7A
Chapter 9 Installment Sales and Like-kind Exchanges	1. A new example and related illustration demonstrate the installment gain computation.	Key Issue 9A and Illustration 9-1
	2. Addressed the application of the new 3.8% net investment income tax (NIIT) to a disposition of S stock.	Key Issue 9A

<u>Chapter</u>	<u>Substantive Changes and Additions</u>	<u>Reference</u>
	3. Clarified the need to use Form 8949 (Sales and Other Dispositions of Capital Assets) for reporting the election out of the installment sale for S corporation assets.	Key Issue 9F
Chapter 10 Trade or Business Property Transactions	1. Discussed the reporting implications of new Form 8949 which is used to list sales and other dispositions of capital assets.	Key Issue 10A
	2. Provided a new table summarizing where to make the first reporting entry for dispositions of common types of property.	Key Issue 10A
	3. Updated and revised the explanation of reporting sales of qualified small business stock on Form 8949 and Schedules K and K-1.	Key Issue 10A
	4. Provided discussion of the building component disposition rule allowing the write-off of structural components when they are retired.	Key Issue 10E
Chapter 11 Debt Discharge Income and Foreclosures	1. The discussion of deferring and ratably recognizing certain income from debt reacquisition has been updated for the release of final regulations.	Key Issues 11I
	2. The requirement to report cancellations of debt on Form 1120S has been noted.	Key Issue 11J
Chapter 12 Compensation	1. Covered a recent case in which compensation paid to a shareholder/employee was determined to be unreasonable because it failed the independent investor test.	Key Issue 12A
	2. This edition discusses how S corporations are affected by new Form 1125-E (Compensation of Officers), and a sample filled-in Form 1125-E has been provided.	Key Issue 12A and Illustration 12-1
	3. Discussed the Section 6694(a) tax understatement preparer penalty and how to avoid it when reasonable compensation issues are involved.	Key Issue 12A
Chapter 13 Bad Debt Losses	1. Updated discussion on tax return presentation of nonbusiness bad debts.	Key Issue 13A
	2. An exception to the specific charge-off method for partially worthless debts is explained.	Key Issue 13B
Chapter 14 Taxes and Interest	1. The discussion of the recurring item exception for accrual method taxpayers has been updated for a new requirement spelled out in a recent IRS ruling.	Key Issue 14B
Chapter 15 Depreciation and Depletion	1. The discussion on accounting for tangible property has been updated for the recent issuance of final and proposed regulations.	Key Issue 15C
	2. A new table compares important provisions in the 2011 temporary tangible property regulations and the 2013 final regulations.	Illustration 15-7
Chapter 16 Fringe Benefits and Retirement Plans	1. The discussion has been expanded to include the taxable or nontaxable nature of reimbursements to an employee for use of his or her cell phone for business purposes.	Key Issue 16A
	2. This edition provides the definition of <i>compensation</i> for purposes of the SIMPLE IRA plan rules and discusses how this definition affects 2% shareholder-employees.	Key Issue 16D

<u>Chapter</u>	<u>Substantive Changes and Additions</u>	<u>Reference</u>
Chapter 17 Travel and Entertainment	1. Recently released IRS guidance on whether a wage recharacterization arrangement qualifies as an accountable plan is included and explained.	Key Issue 17A
	2. The discussion of the per diem method of substantiating travel expenses has been updated for the latest available IRS guidance.	Key Issue 17A
	3. Expanded discussion addresses recent final regulations that clarify how the 50% meal deduction limit applies to reimbursements involving three parties.	Key Issue 17B
	4. The discussion of the standard auto mileage rate has been updated for the most current IRS guidance.	Key Issue 17E
	5. The discussion of the annual lease value inclusion for leased autos has been updated for the most current IRS guidance.	Key Issue 17F
Chapter 18 Other Deductions	1. Alerted readers to an IRS memo that includes a process for determining whether certain taxpayers have the benefits and burdens of ownership for purposes of calculating the Section 199 deduction.	Key Issue 18A
	2. The discussion of activities that qualify for the Section 199 deduction has been expanded.	Key Issue 18A
	3. Clarified when outplacement services to help employees find new employment is deductible as a business expense.	Key Issue 18E
Chapter 19 Shareholder Stock Basis	1. Pointed out that distributions of money in excess of an S shareholder's adjusted basis that result in gain recognition can be subject to the net investment income tax.	Key Issue 19C
	2. Revised and clarified the discussion of the importance of correctly tracking stock basis.	Key Issue 19I
Chapter 20 Shareholder Debt Basis	1. Pointed out how capital gains from the repayment of shareholder loans are treated for net investment income tax purposes.	Key Issue 20B
Chapter 21 Distributions	1. A summary of the 2013 long-term capital gain and qualified dividend tax rates has been included in this edition.	Key Issue 21A
	2. The treatment of taxable and tax-free distributions from an S corporation for net investment income tax purposes has been provided.	Key Issue 21A
	3. Explained that statements providing certain information relating to distributions made during the year must be attached to the corporation's tax return.	Key Issue 21P
Chapter 22 Property Transactions with Shareholders	1. The discussion has been expanded to cover how the related party rules are affected by the Supreme Court's ruling in the <i>Windsor</i> case.	Key Issue 22B
Chapter 23 Schedule L—The Balance Sheet	1. A chart from the Internal Revenue Manual has been included to illustrate IRS examination techniques that are applied to Schedule L balance sheets.	Key Issue 23F
Chapter 24 Schedules M-1 and M-3	1. A recent revenue procedure providing that certain S corporations must file Schedule B (Additional Information for Schedule M-3 Filers) is discussed.	Key Issue 24G

<u>Chapter</u>	<u>Substantive Changes and Additions</u>	<u>Reference</u>
Chapter 26 Schedules K and K-1—Pass-through	1. New discussion explains how the taxation of S corporation pass-through items, distributions to shareholders, and sales of S corporation stock are affected by the net investment income tax.	Key Issue 26K
	2. New discussion covers how wages and self-employment income are affected by the new 0.9% additional Medicare tax on earned income.	Key Issue 26K
Chapter 27 Alternative Minimum Tax	1. An updated table provides the current increased alternative minimum tax (AMT) exemption and phase-out amounts.	Key Issue 27B
	2. Explained how qualified dividends received by an S shareholder are treated for AMT purposes.	Key Issue 27G
	3. Pointed out the potential effect of the net investment income tax on the 20% maximum tax rate that applies to capital gains and qualified dividend income.	Key Issue 27G
Chapter 28 Business Credits	1. The discussion has been updated for law changes to the new qualified plug-in electric drive motor vehicle credit.	Key Issue 28F
	2. Expanded discussion of the fuel tax credit covers the cellulosic biofuel producer credit and second generation biofuel producer credit.	Key Issue 28J
	3. Recent IRS guidance on classifying customer payments as tips rather than service charges has been covered.	Key Issue 28H
	4. The discussion of the small employer health insurance credit has been updated for recently released proposed regulations.	Key Issue 28K
Chapter 29 Foreign Taxes	1. The discussion of reporting specified foreign accounts has been updated for recent IRS notification that delays required reporting by specified domestic entities.	Key Issue 29D
Chapter 30 Shareholder Losses: Basis Limitations	1. This edition discusses how the transfer of carryover losses between spouses is affected by the Supreme Court's decision that Section 3 of the Defense of Marriage Act is unconstitutional.	Key Issue 30D
Chapter 31 Passive Activity Loss	1. The one-time regrouping of passive activities allowed under the 3.8% net investment income tax (NIIT) rules is explained.	Key Issue 31A
	2. An expanded example illustrates how rental income treated as a trade or business for passive activity purposes can be subject to the 3.8% NIIT.	Key Issue 31D
	3. Expanded discussion explains how items recharacterized from passive to nonpassive under the recharacterization rules can be subject to the 3.8% NIIT.	Key Issue 31D
	4. The definitions of <i>trade or business income</i> under the Section 1362 passive investment income rules and the Section 1411 rules relating to the new 3.8% NIIT have been compared.	Key Issue 31R
Chapter 33 Built-in Gains Tax	1. Pointed out that gain on the sale of an S corporation's assets can be subject to both the 3.8% net investment income tax (NIIT) and the built-in gains tax.	Key Issue 33A
	2. An updated and revised table summarizes how the effective date of the S election affects the recognition of built-in gains during 2013, which is the last year that is eligible for the suspension period.	Key Issue 33M

<u>Chapter</u>	<u>Substantive Changes and Additions</u>	<u>Reference</u>
	3. Explained how built-in gains that are exempt from corporate tax during the suspension period are reported on Form 1120S.	Key Issue 33M
Chapter 34 Tax on Excess Net Passive Income	1. The definitions of <i>rental income</i> under the Section 1362 passive investment income rules and the Section 1411 rules relating to the new 3.8% net investment income tax (NIIT) have been compared.	Key Issue 34A
	2. Explained that investment income can be subject to both the 3.8% net investment income tax (NIIT) and the excess net passive income tax.	Key Issue 34F
Chapter 35 Other Tax Payments	1. The first time abatement policy allowing IRS personnel to waive failure to pay penalties is discussed in this edition.	Key Issue 35G
Chapter 36 Termination of S Status	1. New discussion covers a case in which the 5th Circuit ruled on whether a solvent parent S corporation's revocation of its S election was valid when the revocation caused its bankrupt QSub to become a C corporation.	Key Issue 36A
	2. Expanded discussion explains when suspended losses can be used during the post-termination transition period (PTTP).	Key Issue 36F
	3. A new key issue discusses how an S corporation may be affected by the net investment income tax in the year the S election terminates.	Key Issue 36I
Chapter 37 Stock Dispositions	1. The discussion of tax consequences of selling S stock has been expanded.	Key Issue 37A
	2. A new key issue explains how the net investment income tax's deemed sale rule affects gain or loss recognition on dispositions of S corporation stock.	Key Issue 37G
Chapter 38 Changes in Corporate Capital Structure	1. New discussion reviews the accounting methods available to the parent S corporation and the subsidiary when a QSub election is made for the subsidiary.	Key Issue 38A
	2. The discussion of obtaining relief for a late QSub election has been updated for recently released IRS procedural guidance.	Key Issue 38C
	3. New discussion explains whether the 3.8% net investment income tax applies in a stock redemption situation.	Key Issue 38D
Chapter 40 Accounting Methods	1. The discussion of the <i>all events test</i> has been revised and clarified.	Key Issue 40A
	2. A new example illustrates the timing of the deduction for inventoriable items treated as nonincidental materials and supplies.	Key Issue 40C
	3. A new example illustrates the long-term contract adjustment for AMT purposes for a cash basis S corporation.	Key Issue 40F
	4. The discussion of automatic changes under the tangible property regulations has been updated.	Key Issue 40H
Chapter 41 Filing and Amending Form 1120S, Corporate Audits, and Penalties	1. The limitations and exceptions to the rule prohibiting the disclosure and use of tax return information have been discussed.	Key Issue 41B
	2. Selected comments and observations made by the Director of the IRS's Office of Professional Responsibility have been included.	Key Issue 41C

<u>Chapter</u>	<u>Substantive Changes and Additions</u>	<u>Reference</u>
	3. First time penalty abatement and reasonable cause for avoiding penalties has been discussed.	Key Issues 41E
	4. Expanded discussion explains the potential imposition of penalties on the firm or employer of a penalized return preparer.	Key Issue 41G
QUICK REFERENCE TABLES	1. The flowchart for obtaining relief from a late S election has been revised to reflect the changes made by a recent IRS revenue procedure.	Table T105
	2. A flowchart illustrating how a qualified Subchapter S trust (QSST) or electing small business trust (ESBT) can request relief from a late or QSST or ESBT election is furnished.	Table T106
	3. A flowchart illustrating how a parent S corporation can request relief for a late qualified Subchapter S subsidiary (QSub) election is furnished.	Table T107
	4. The table of interest rates on overpayments and underpayments of tax has been updated for 2013 rates.	Table T301
	5. A table of available 2013 applicable federal rates (AFRs) has been provided.	Table T301
	6. The table comparing qualified plan features has been updated to reflect the 2013 limits.	Table T502
	7. The table of standard mileage rates has been updated for the most current IRS-provided rates.	Table T601
	8. The table on valuing personal use of an employer-provided auto has been updated for the most current IRS-provided inflation-adjusted amounts.	Table T605
TAX ELECTIONS	1. The election for obtaining an IRS waiver of the effects of an invalid or late S election has been updated to reflect changes made by a new revenue procedure.	Election E104
	2. The qualified Subchapter S trust (QSST) election and the electing small business trust (ESBT) election have been amended to include revised procedures for obtaining relief for a late election as set out in a new revenue procedure.	Elections E106 and E109
	3. The QSub election has been updated for recently revised late election procedures.	Election E106
WORKSHEETS	1. The worksheet for computing the built-in gains tax has been updated for the five-year recognition period that may apply to certain gains recognized in 2013.	Worksheet W401
ADDITIONAL PREPARATION RESOURCES	1. The quick access federal data sheet has been updated to provide 2014 rates, in addition to those for 2012 and 2013.	Resource R501