# Selected Pass-Through Entity Tax Issues

**Pennsylvania Bar Institute**

**August 1, 2023**

# The Panel

Christopher A. Jones, Esquire
Ballard Spahr LLP
Jonesc@ballardspahr.com
215.864.8424

Wendi L. Kotzen, Esquire
Ballard Spahr LLP
Kotzenw@ballardspahr.com
215.864.8305

Morgan Klinzing, Esquire
Troutman Pepper
Morgan.Klinzing@troutman.com
215.981.4560

Dean V. Krishna, Esquire
Stradley Ronon
dkrishna@stradley.com
215.564.8707

# Agenda

- Partnership M&A Tax Considerations
- S Corporation M&A Tax Considerations
- S Corporation F Reorganizations
- EIN-Related Issues
- Tax Due Diligence Considerations
- Selected Employment Tax Consideraions

# Partnership M&A Tax Considerations

# Sale of a Partnership Interest – Entity v. Aggregate

- The Code takes a middle ground on the sale of a partnership interest.

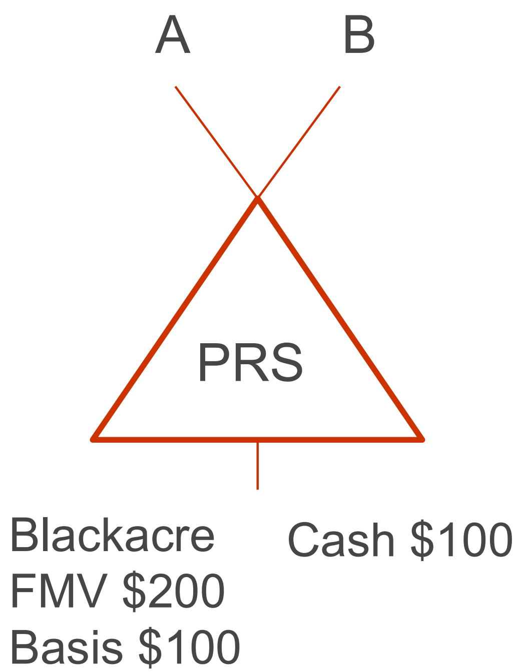
- General Rule: Entity Approach
  - IRC § 741: Gain or loss on the sale of a partnership interest is capital.

- Exceptions: Aggregate Approach
  - IRC § 751: Part of the gain or loss is ordinary to the extent attributable to certain ordinary income assets.
  - IRC § 754 Election or Substantial Built-in Loss: Adjustments to the basis of partnership assets.

# Aggregate vs. Entity

## Sale of Partnership Interests

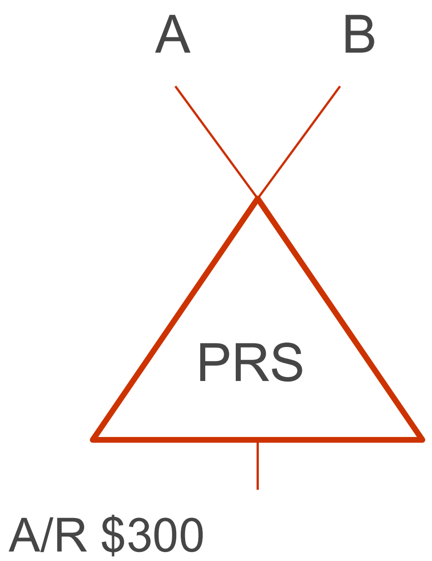
- Entity: Sale of interests without regard to character of the assets
- Aggregate: Sale of partnership's interest in underlying assets.




- Hypo: Each of A and B contribute $100 cash to PRS. PRS buys Blackacre for $100. One year later, B wants to sell his interest in PRS to C for $150. Differences in treatment if sale of interest v. asset?

# Aggregate vs. Entity

## Sale of Partnership Interests




- Hypo: Each of A and B contribute $100 cash to PRS. One year later, PRS holds account receivables of $300. B wants to sell his interest in PRS to C for $150. Differences in treatment if sale of interest v. asset?

# Section 751 Considerations

- IRC § 751(a): The amount of any money, or the fair market value of any property, received by a transferor partner in exchange for all or a part of his interest in the partnership attributable to:
  - unrealized receivables of the partnership, or
  - inventory items of the partnership

shall be considered as an amount realized from the sale or exchange of property other than a capital asset.

- Commonly referred to as “hot assets.”

- IRC § 751 Regulations use a hypothetical sale approach to determine gain attributable to hot assets.

- No installment sale treatment for IRC § 751 gain.

# Election to Step-up Basis

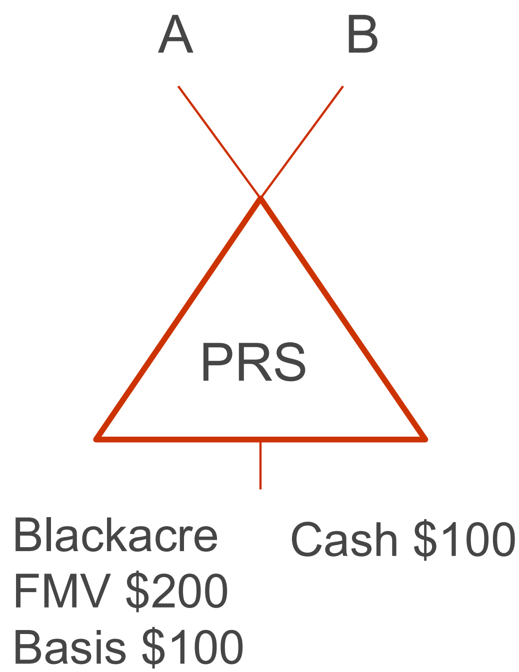
- IRC § 754 election allows a basis adjustment under IRC § 743(b) related to the selling partner's recognition of gain or loss on the sale of the interest.
- Default is no adjustment to basis of assets → basis disparity for inside and outside basis.
  - Basis disparity can lead to surprising results.
- Adjustment is mandatory if the partnership has a substantial built-in loss.

# Disguised Sale

- A sale of a partnership interest relies on the entity theory, not the aggregate theory.
  - This means the ownership interest a partner has in a partnership is treated as a separate asset that can be purchased and sold.
- The general rule is the selling partner treats the gain or loss on the sale of the partnership interest as the sale of a capital asset (see IRC § 741).

# Disguised Sale Rules

- Hypo: C wants to put in cash of $100. PRS will distribute $100 cash to B.

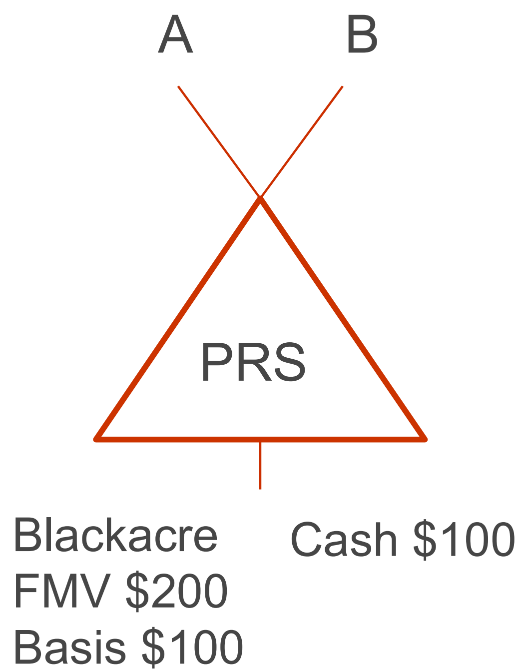



- IRC § 707(a)(2)(B): If there is (i) a transfer of money or other property to a partnership, and (ii) a related transfer of money or other property by the partnership to a partner, and (iii) the transfers are properly characterized as a sale or exchange, then it is treated as a sale.

# Sale of 100% of a Partnership Interest

## Partnership Termination

- Hypo: A and B want to sell their interests in PRS to C for $300.




- PRS terminates under IRC § 708.
- A and B each treat the transaction as a sale of a partnership interest under IRC § 741.
- For C, PRS is deemed to make a liquidating distribution of all of its assets to A and B, and C is treated as purchasing the assets.
  - Stepped up asset basis and new holding period.
- Rev. Rul. 99-6, Situation 2

# Other Partnership M&A Considerations

- Allocations of Income in the Year of the Sale
- Allocations of purchase price to IRC § 751 property
- Tax Distributions
- Partnership Audit Rules
  - Mandatory push-out elections
- Control Over Tax Returns
- Structuring Considerations – partnership continuations, mergers, divisions

# S Corporation
# M&A Tax Considerations

# S Corporations

## Basics

- S Corporations
  - No more than 100 owners
  - One class of stock only
  - Individual U.S. owners (ESBT / QSST / grantor trust / voting trusts)
  - Allocate proportionally
  - Less flexible
  - Must keep accumulated adjustments account (AAA), which is essentially a running account of the undistributed net income of the corporation
    - Income is ordinary income if the character of the income at the S Corporation level is ordinary
    - Distributions are capital gains
  - FICA play (forthcoming)
  - PA: automatic conformity (NJ: automatic conformity (new; effective 12/22/2022))
  - 4.7M S Corp returns in 2017; 4.4M in 2014; 3.3M in 2003 (US)

- S Corporations: Trends

- S to C after 2017

# S Corporations

## M&A Considerations

- IRC § 1377(a)(2) Election…
  - Sales of S corp stock: <u>default is proration</u> for year (unlike partnerships)
  - Treas. Reg. § 1.1377-1(c), Example 2: <u>end of day</u> (“through”) allocation.
    - Depending on facts, Internal buyout should occur day before sale to third party.

- Or IRC § 1368?
  - Treas. Reg. § 1.1368-1(g): 20% sales.
  - If 100%, IRC § 1377 controls.

- Example: COD income if part of buyout (or in year of buyout):
  - Allocated to new shareholder unless IRC § 1377 election is made. Treas. Reg. § 1.108-7 *ex 7*.

# S Corporations

## M&A Considerations

- Exiting Shareholders: Second class of stock vs. redemption

- Distributions of Property
  - Who should bear IRC § 311 incidence?
  - Assumed tax rates
  - Basis to stockholders
  - Holding period

# S Corporations

## M&A Considerations

- IRC § 338(h)(10) Election
  - Deemed asset sale
  - Lack of PA recognition for S corporations
  - Challenges when rollover equity involved
  - Gross up considerations (allocations / recapture; different state rates)
  - Prior C history (built in gains tax)
  - Compare to F reorg
- Sale of Personal Goodwill?
  - Local tax considerations
  - Holding period
- IRC § 336(e) Election

# S Corporations

## M&A Considerations

- Transaction Costs
  - Deemed time of termination of S year
  - Deductions for change in control payments
  - Solutions for allocation

- S Corporations after Asset Sales
  - If C Corp history, beware IRC §§ 1362 and 1375 regarding passive income
  - Distribution of installment note (IRC § 453(h))

- Sale of QSubs
  - Sale of disregarded entity, with particular deemed steps described in Treas. Reg. § 1.1361-5(b)(3), Example 9.

# S Corporation
# F Reorganizations

# What is an F Reorganization – IRC § 368(a)(1)(F)

**A mere change in identity, form, or place of organization of one corporation**

- Same shareholders before and after (minor differences are permitted);
- Identity of Ownership - The shareholders retain their same proportionate ownership;
- The resulting corporation must not have held any assets or have any tax attributes of its own prior to the reorganization;
- The original corporation must liquidate;
- Only the resulting corporation may hold assets owned by the original corporation; and
- The resulting corporation cannot hold assets of any other corporation other than the original corporation.

# F Reorganization steps in M&A Transactions for Target S Corporation

1. Shareholders of Target S Corp contribute their shares of Target S Corp to New Corp.

2. New Corp elects to cause Target S Corp to be a QSUB (satisfying the liquidation requirement) by filing an IRS Form 8869.

    a. The effective date of the QSUB selection should be simultaneous with the date the shareholders contribute the stock of Target S Corp to New Corp.

    b. The QSUB election should be effective before Target S Corp is converted to an LLC because the entity making the QSUB election must be a corporation when the election is filed.  See PLR 201724013.

# F Reorganization steps in M&A Transactions for Target S Corporation

c. The IRS Form 8869 now includes a question as to whether the QSUB election is in connection with an F Reorg.

d. Many practitioners make a protective S election (IRS Form 2553) for New Corp.

3. New Corp becomes an S Corp by virtue of carrying over Target S Corp's S election (Rev. Ruls. 2018-18 and 64-259).

a. The instructions to the IRS Form 8869 make clear that New Corp succeeds to Target S Corp's S election without filing a new S election.

b. New Corp is a continuation of Target S Corp and, as a result, there is no short tax year.

# F Reorganization steps in M&A Transactions for Target S Corporation

c. A statement required by Treas. Reg. § 1.368-3 describing the F Reorg should be attached to New Corp's initial tax return which statement should include, *inter alia*, the names and EINs of the corporations involved in the F Reorg, the date of the F Reorg, and the value and tax basis of Target S Corp's assets.

d. Target S Corp (now a Q Sub) retains its EIN (and New Corp obtains a new EIN). See Treas. Reg. § 301.6109-1(i) and Rev. Rul. 2008-18. See also Treas. Reg. §§ 301.6109-1(h)(2)(ii) and 301.6109-1(i)(3).

e. There are several PLRs concluding these steps are an F Reorg – see *e.g.*, 200725012 and 200701017.

# F Reorganization steps in M&A Transactions for Target S Corporation

4. After it becomes a QSUB, Target S Corp frequently converts to an LLC – which is a disregarded entity to disregarded entity nonevent for tax purposes.

    a. The state law conversion from a corporation to an LLC that will not check the box allows the buyer to be assured of a step-up in basis, even if Target S Corp does not have a valid S election (But, if Target S Corp does not have a valid S election, the sale will result in corporate level tax).

# F Reorganization steps in M&A Transactions for Target S Corporation

5. After Steps 1-5, Buyer can acquire all or part of what was Target S Corp.

    a. Buyer can purchase all or part of the LLC (that was Target S Corp).

    b. New Corp can contribute all or a portion of the LLC interests in the LLC (that was Target S Corp) to Buyer or Buyer's acquisition entity.

        i. Frequently, New Corp gets roll-over equity –

# F Reorganization steps in M&A Transactions for Target S Corporation

1. The Buyer buys X% of the LLC (that was Target S Corp) for cash and New Corp contributes the remainder of the equity of LLC to Buyer or its acquisition entity in exchange for equity of Buyer or its acquisition entity.

2. For New Corp, under Rev. Rul. 99-6, such a transaction is treated as a part sale, part contribution.

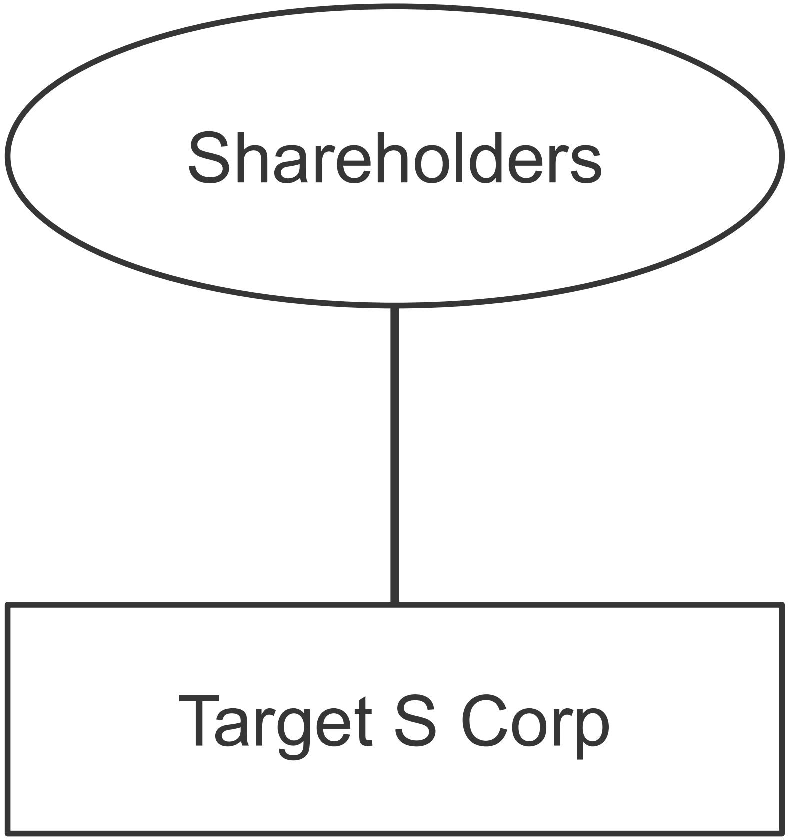
# Results of F Reorganization Structure

This structure allows:

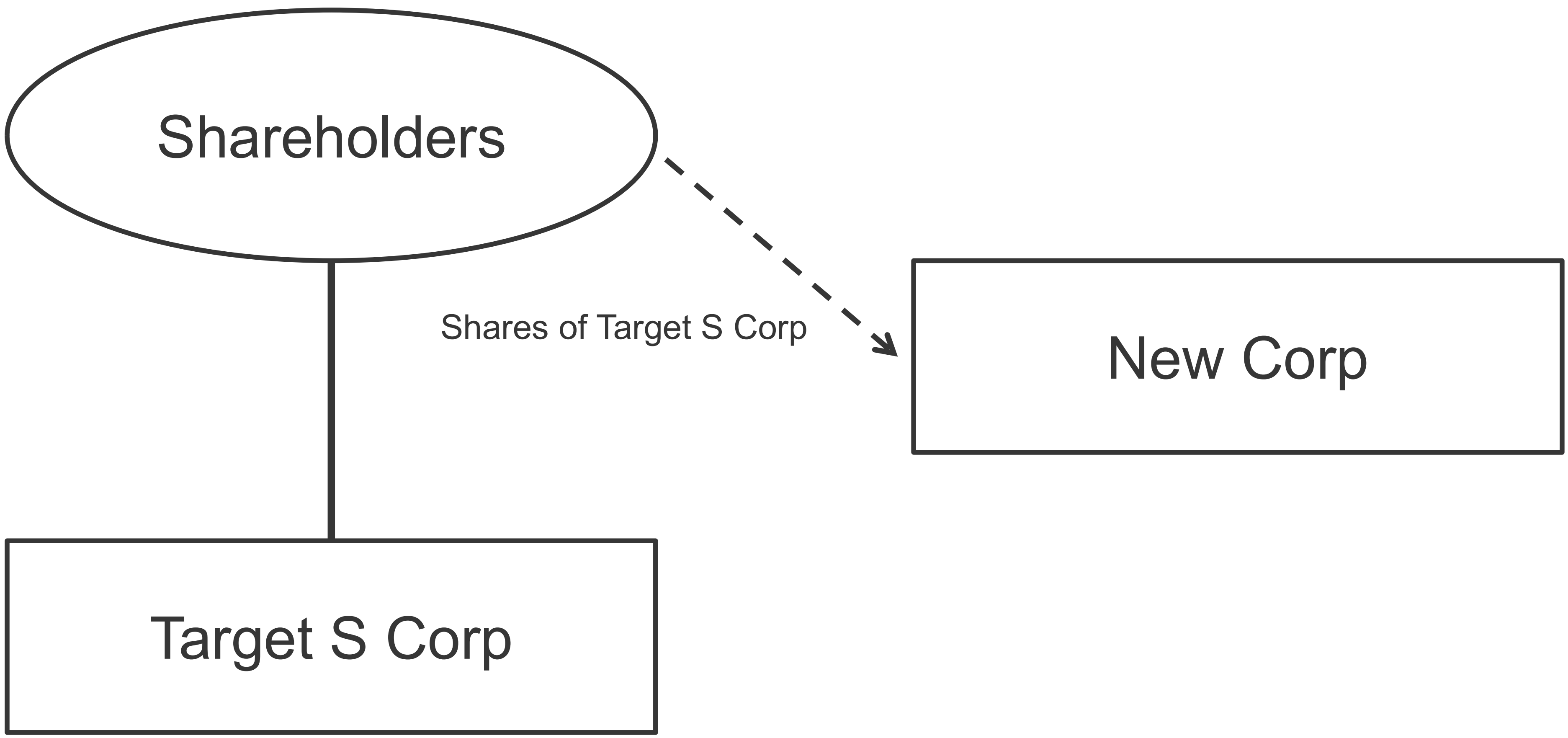
- The shareholders of Target S Corp to defer gain on roll-over equity. However, the roll-over equity will be held by New Corp and cannot be distributed to the shareholders without recognition of gain. But as noted above, if Target's S election is invalid, there will be corporate level tax.

- The buyer to obtain a step up in basis for the cash purchase price, avoid depending on the validity of Target S Corp's S election, and facilitate an entity interest purchase.

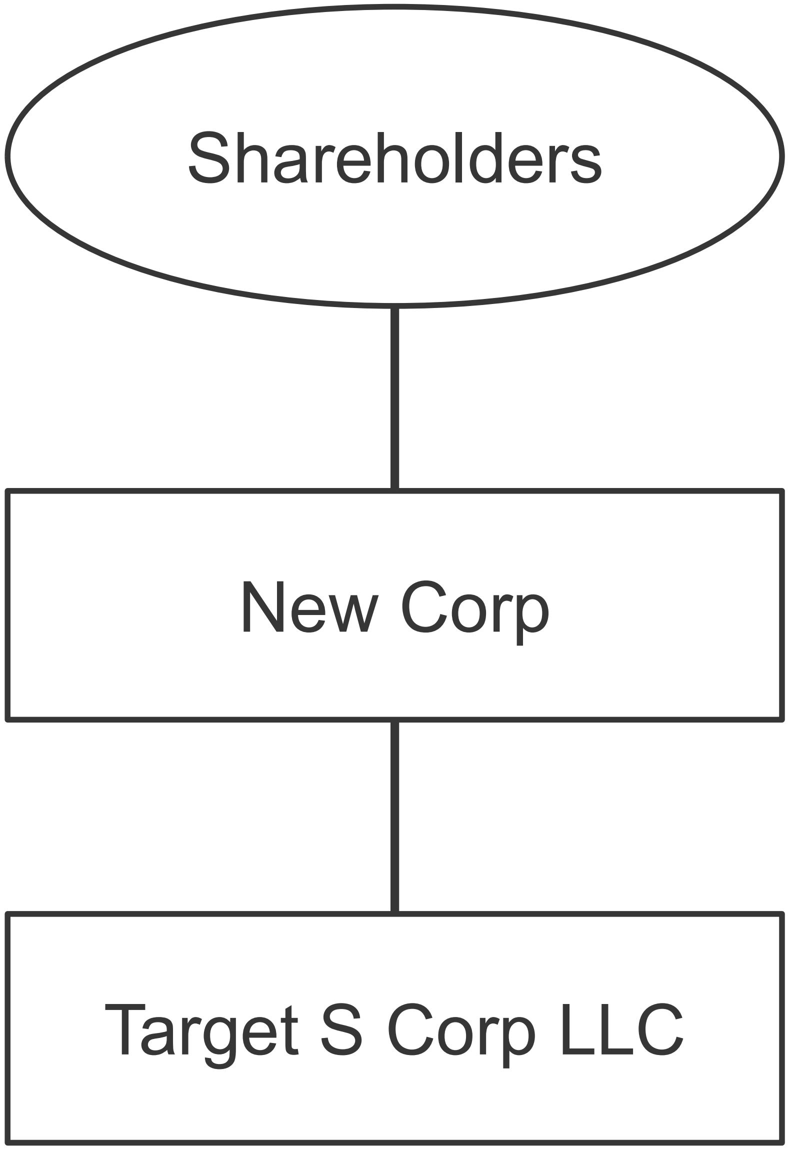
# Before Transaction



# Step 1



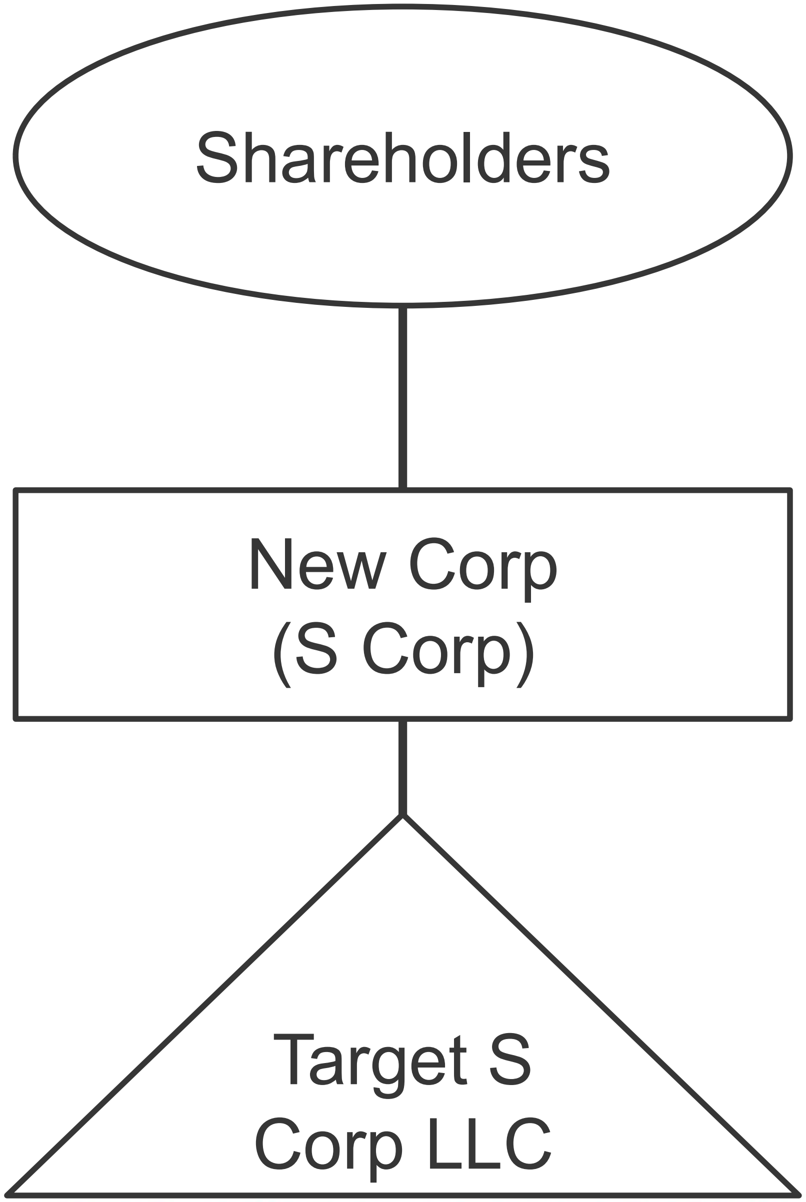
# After Step 1




New Corp Becomes an S Corp

New Corp Elects to treat Target S Corp as a QSUB and may make protective S election

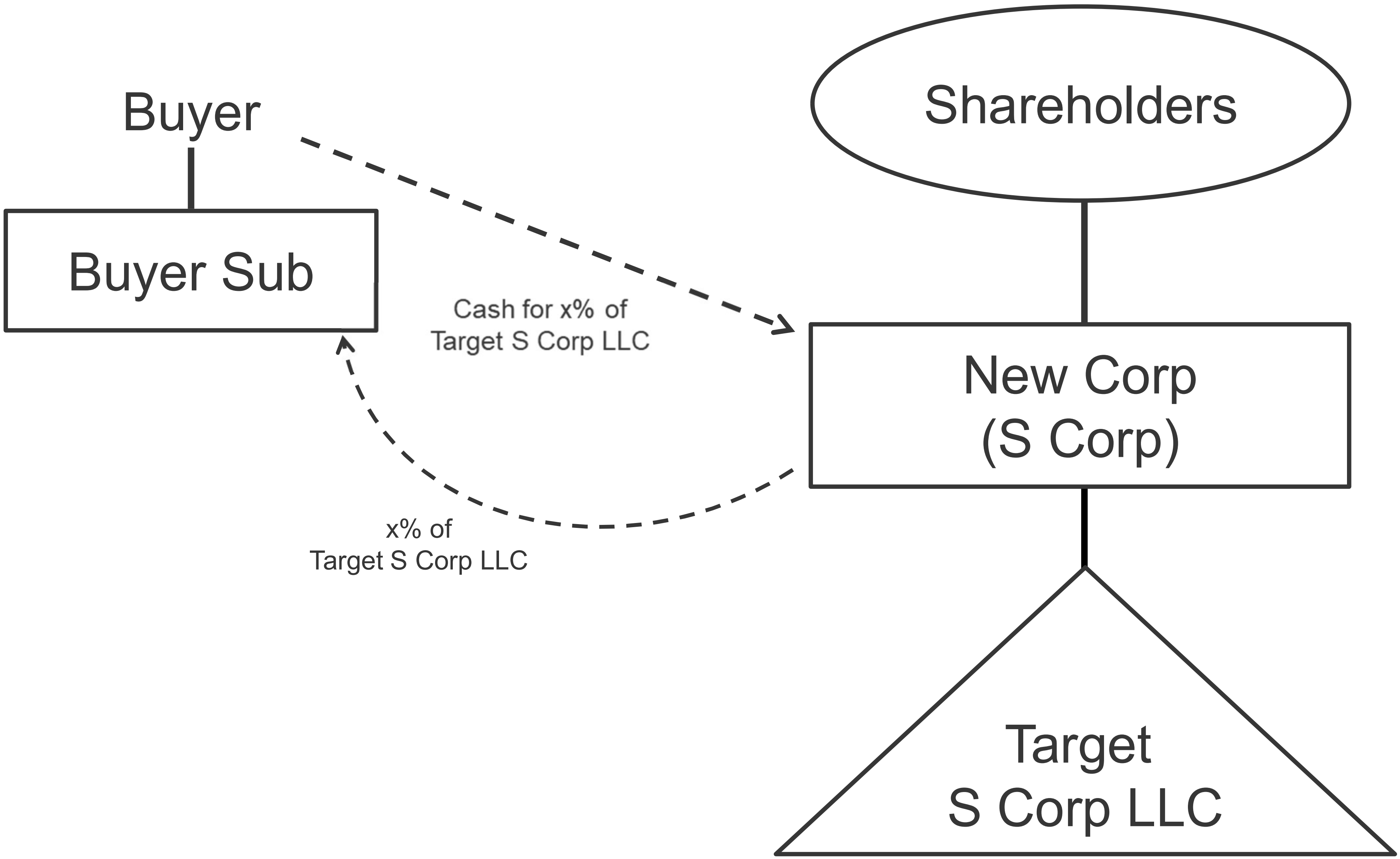
# Step 2




Target undergoes a state law conversion to an LLC

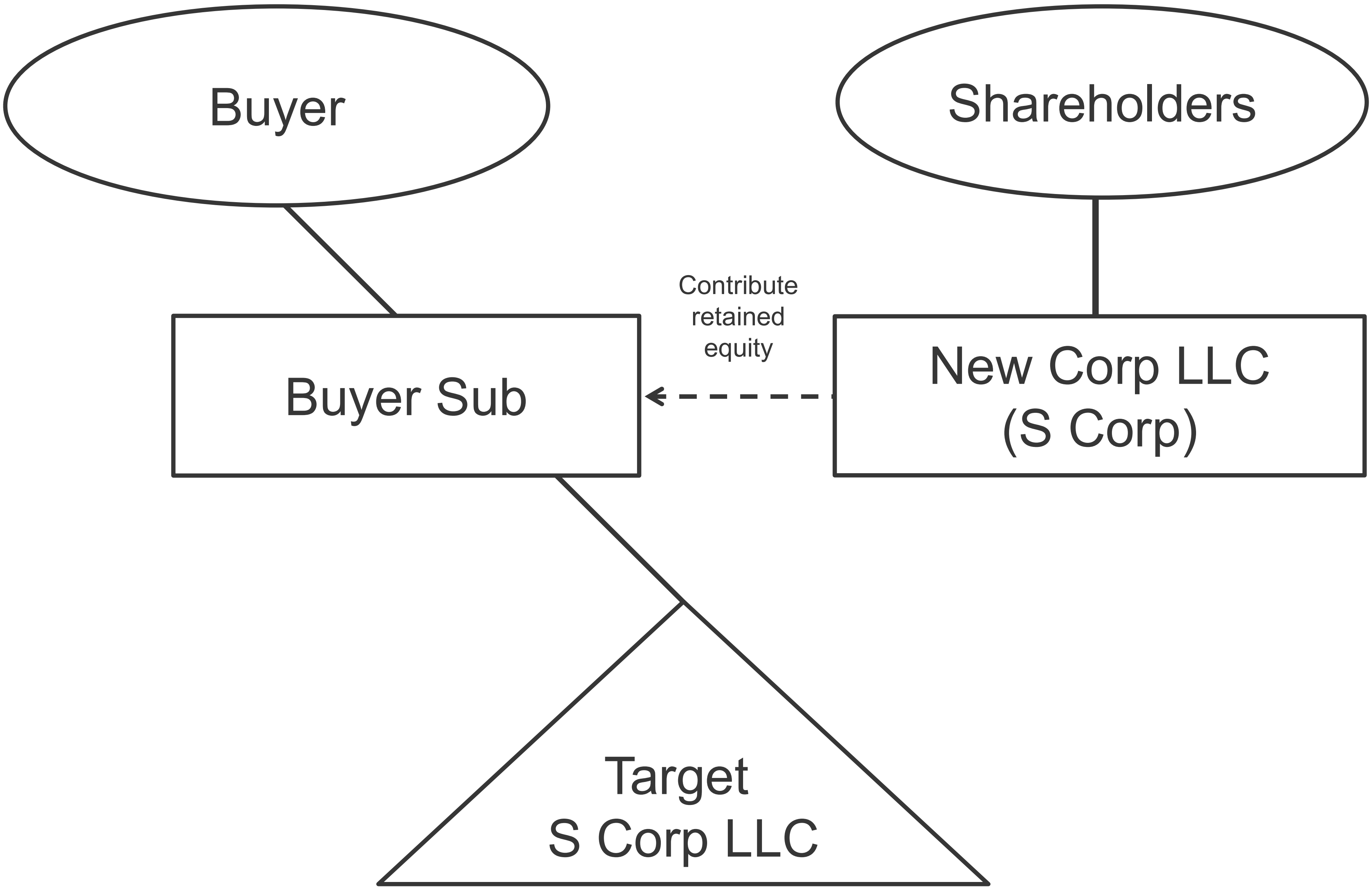
Target remains a DRE – QSUB to SMLLC

# Step 3

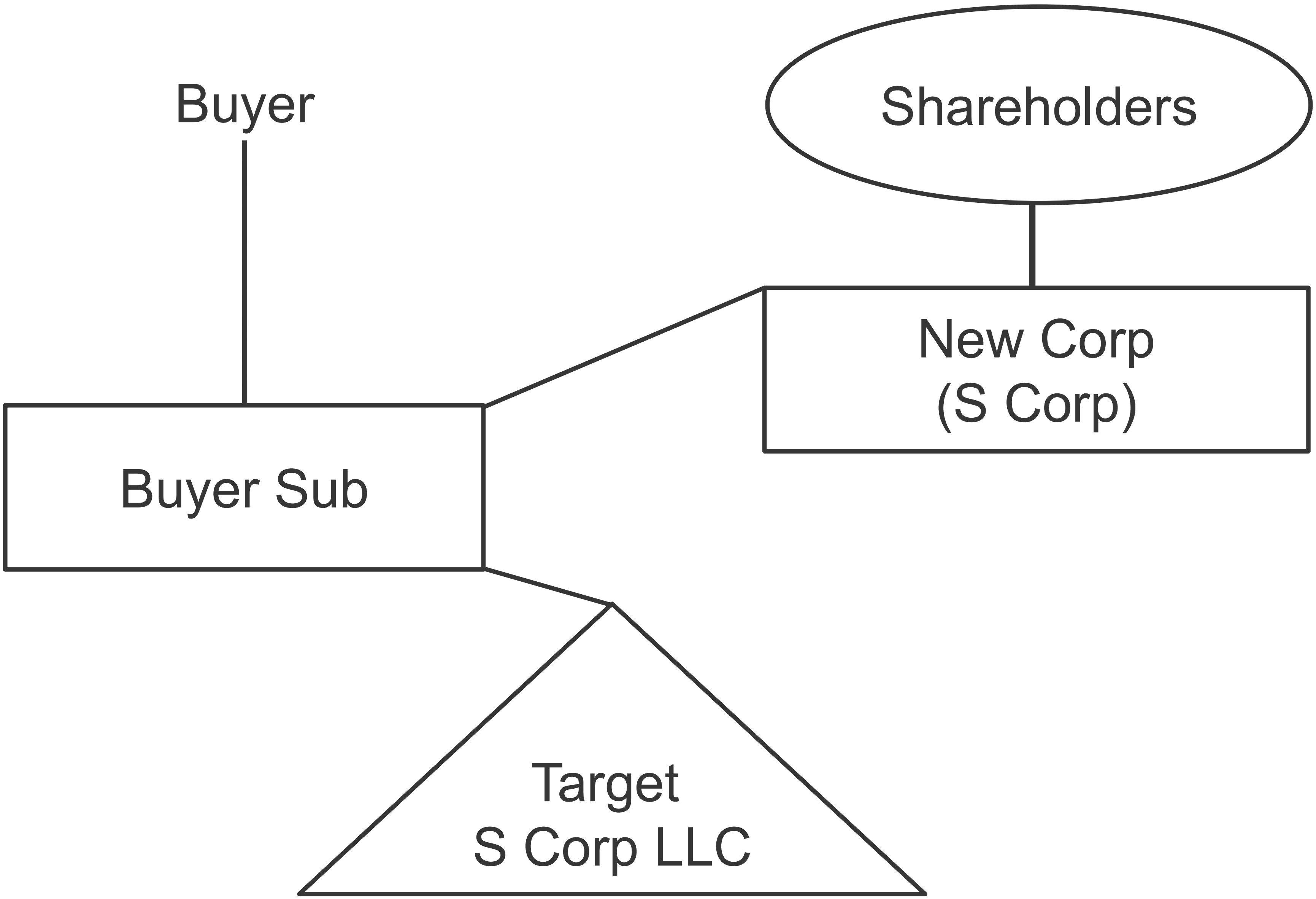


Buyer
Buyer Sub
Shareholders
Cash for x% of
Target S Corp LLC
New Corp
(S Corp)
x% of
Target S Corp LLC
Target
S Corp LLC

# Step 4


Buyer
Shareholders
Contribute retained equity
Buyer Sub
New Corp LLC (S Corp)
Target S Corp LLC

# Post Transaction



# EIN-Related Issues

# What is an Employer Identification Number?

An employer identification number (EIN) is:

- A unique nine-digit number (XX-XXXXXXX) primarily used to identify the tax accounts of employer, but also used to identify entities.
- Issued by the IRS but frequently used by other parties – *e.g.*, state taxing authorities, banks, insurance companies – as the primary identification of a business.
  - This can lead to a number of headaches because the IRS systems that given EINs can be very inflexible and EINs can be very important for businesses.

# Applying for an EIN

A business may obtain an EIN:

- Online through www.irs.gov;
- By fax;
- By Mail

Every application for an EIN must be associated with a “responsible person.” This must be an individual (not a business) who has a social security number. The EIN system verifies the responsible person’s identity as part of the process.

# Applying for an EIN – Frequent Problems

- In some situations, it can be difficult to find a responsible person
  - For example, a business trust formed as a grantor trust. In many cases, the sole trustee is a corporate trustee. Many persons associated with the corporate trustee are (rightly) reluctant to provide their SSN for the application process.
    - Can an attorney or other person familiar with the transaction act as responsible person?
  - When applying for a single-member LLC, the confirmation letter automatically lists the responsible person as the “sole member” which can cause a lot of confusion.

# Single-Member LLCs - EINs

- If a single-member LLC is disregarded from its parent for income tax purposes, no EIN is required for income tax purposes.
- However, if the single-member LLC has employees, under Treas. Reg. § 301.7702-2(c)(iv)(B), the single-member LLC is treated as a corporation for employment tax purposes and is required to obtain an EIN and file employment tax returns separately from its parent.
- A single-member LLC also *may* obtain an EIN for banking purposes or to use for state tax accounts (sales tax etc.).
  - BUT – When completing a W-9, the single-member LLC is required to use the EIN of its required parent.

# Single-Member LLCs - EINs

- If a single-member LLC is disregarded from its parent for income tax purposes, no EIN is required for income tax purposes.

- However, if the single-member LLC has employees, under Treas. Reg. § 301.7702-2(c)(iv)(B), the single-member LLC is treated as a corporation for employment tax purposes and is required to obtain an EIN and file employment tax returns separately from its parent.

- A single-member LLC also *may* obtain an EIN for banking purposes or to use for state tax accounts (sales tax etc.).

  - BUT – When completing a W-9, the single-member LLC is required to use the EIN of its required parent.

# Changes that do NOT require a new EIN

- Change to the name/address of the entity.
- Re-Domestication to new state.
- F Reorganization of existing corporation.
  - Note that Rev. Rul. 2008-18 expressly concludes that the target S corporation (the S corporation that exists before the F Reorganization) retains the pre-F Reorganization EIN. This is not entirely consistent with the transaction – the target is deemed to become New Corp. But, presumably, the IRS recognized the importance of EINs in these types of acquisitive transactions.

# Changes that do require a new EIN

- Sole proprietorship or single-member LLC with no employees incorporates under state law.

- In a corporate merger the entity that goes out of existence may not continue to use its EIN.  The EIN of the surviving corporation must be used for the merged corporation.

# What about conversions? New EIN?

- What happens to an existing entity's EIN when it converts to a different type of entity?
  - State law conversion only – *e.g.*, state law limited partnership converts to state law LLC that is treated as a partnership for income tax purposes – no new EIN is required.
    - The state law conversion paperwork should be mailed to the IRS to process a name change that results from such a conversion.
    - Processing can take a VERY long time and can result in headaches with returns filed in the meantime (*e.g.*, quarterly employment tax returns).

# Conversions continued...

- If the federal income tax classification changes, the answer is much less clear.

- In Rev. Rul. 2001-61, the IRS ruled that, when a partnership becomes a disregarded entity because it becomes 100% owned by the same person (a Rev. Rul. 99-6 transaction), the disregarded entity keeps its EIN and should use that EIN if the disregarded entity has employees.

- Moreover, the IRS ruled that – if such entity becomes regarded again – it should continue to use that EIN if it files income tax returns in the future.

  - Note that there could be dormancy concerns.

# Conversions continued...

- In IRS Publication 1635 (Understanding Your EIN) and on its web site, the IRS states that an entity needs a new EIN in the following situations:
  - An entity treated as a corporation for federal income tax purposes becomes an entity treated as a partnership for federal income tax purposes; and
  - An entity treated as a partnership for federal income tax purposes becomes an entity treated as a corporation for federal income tax purposes.
- This is largely an IRS systems issue – once set up with an entity type, conversion is difficult.

# Conversions continued...

- HOWEVER, Internal Revenue Manual Section 3.13.2.26 (Rev. 04/29/2002) allows entities to request to keep the legacy EIN by writing to the IRS entity division.

- Such a request includes filing a Form 8832, Entity Classification Election, with respect to the entity to process the change in classification in the IRS systems.

  - Note also that the Instructions to the Form 8832 provide that an entity changing its federal tax classification is NOT required to get a new EIN (notwithstanding the IRS guidance elsewhere).

# Common Issue – EIN Retention in F Reorg

HYPOTHETICAL:

- S Corp Target undergoes a pre-closing F Reorganization, converts to an LLC and (pursuant to Rev. Rul. 2008-18) retains its historical EIN after the F Reorganization.

- 100% of Target is acquired by Acquirer.

- Acquirer subsequently transfer partial ownership of Target to another owner, thereby creating a tax partnership.

  - As noted above, the IRS has ruled that Target should continue to use its historic EIN when it begins filing income tax returns.

# EIN Retention in F Reorg

PROBLEM:

- Target is classified as an S Corp in the IRS system – now recognized as a Q Sub because of the election filed pursuant to the F Reorganization.
- IRS therefore rejects Form 1065 filed by Target, which now is a tax partnership.
- Moreover, even after following the IRM procedures, we have been told that the IRS will not process the entity change.

# EIN Retention in F Reorg

POTENTIAL SOLUTION:

- Immediately following the F Reorganization, file Form 8832 on behalf of the new LLC electing an “initial classification” of disregarded entity (or partnership if less than 100% is acquired) using the historic EIN and attaching the state law conversion documents.
- Technically, this contradicts the Form 8832 instructions, which state that the form should not be filed to elect the default status.
- However, we have had some success with this strategy, allowing the post-close entity to file without interruption.

# Tax Due Diligence Considerations

# Tax Due Diligence Basics

- Purpose of Tax Due Diligence
  - Understand tax structure
  - Identify potential exposures
    - Address via representations, special indemnities, VDAs

- Parties to the due diligence process
  - Seller
  - Buyer
  - Seller's accountants
  - Buyer's accountants
  - Seller's lawyers
  - Buyer's lawyers

# Sample Documents to Request

- Corporate structure chart
- Entity classification elections (Form 8832)
- Past income tax returns (all jurisdictions)
- Accountants’ workpapers
- Tax reserves
- FIN 48 workpapers
- Information/materials regarding prior reorganizations
- State income tax allocation calculations
- Foreign tax credit calculations
- Review general accounting methods / elections
- Sales tax returns
- Payroll tax returns

# Items to Consider

- Return Positions
  - Unreasonable compensation
  - Listed/reportable transactions
- Accounting Methods
  - Any IRC § 481 adjustments?
  - Whether transaction will require a change
  - Deferred revenue/prepaid amounts
- Structure
  - Classification of entities
  - Business integration
  - Asset v. equity sale
  - IRC § 338 election
- Historic Audits

# State Sales Tax Considerations

- By far and away the most common type of state tax complication that arises on any transaction is sales tax issues
- Sales taxes are generally considered trust fund taxes, and unless proper tax notice and clearances are obtained from taxing authorities, they will transfer to purchasers
- Regardless of the form of the deal (asset vs. stock)
- Rushed nature of transactions make it very difficult to obtain tax clearance
- Certain states have such a backup for clearance that it is a practical impossibility
- Pennsylvania – Impossible to obtain a clearance certificate before the transaction closes

# Typical Sales Tax Issues

- Nexus
  - Is the company collecting tax everywhere it should be?
  - Footprint states – employees, property, independent contractors
  - Economic nexus – thresholds reached?
- Taxability
  - Is the company collecting and remitting tax properly on its products?
  - Issue typically arises with treatment of software
  - Extrapolation of home state treatment to other states
- Documentation
  - Is the company documenting its exemptions properly, such that as a buyer, the exemptions will withstand audit scrutiny?

# Selected Employment Tax Considerations

# SE Tax: Partners vs. Employees

- Primary differences in the tax treatment of employees and partners:
  - How employees and partners pay <u>income</u> taxes on amounts received from the partnership for services rendered.
  - How employees and partners pay <u>employment</u> taxes, i.e., Social Security and Medicare taxes, Federal Unemployment Tax Act taxes.
- Employment tax payment rules
  - Generally, employees pay 50% of employment taxes and the employer pays the remaining 50% of such taxes.
    - The employer is responsible for withholding the employee’s portion of employment taxes from the employee’s paychecks and remitting it to the IRS.
  - In contrast, partners are generally responsible for paying 100% of self-employment tax.

# Partners vs. Employees - Continued

- Only employers are responsible for paying Federal Unemployment Tax Act taxes.
- Unreimbursed Expenses
  - A partner can deduct unreimbursed, ordinary and necessary business expenses on their tax return and generally reduce earned income for self-employment purposes.
  - An employee cannot deduct any unreimbursed, ordinary and necessary expenses beginning tax year 2018.

# SE Tax and Limited Partners

- Generally, self-employment tax applies to net earnings from self-employment, which is:
  - Gross income from any trade or business carried on by the individual (less deductions); and
  - The taxpayer’s distributive share of partnership taxable income or loss.
- Guaranteed payments for services rendered to the partnership or for the use of capital can be subject to self-employment tax.
- However, if the partner is a limited partner, self-employment tax does not apply to the partner’s distributive share of income or loss.
    - IRC § 1402(a)(13)

# Who Pays SE Tax?

- IRC § 1402 does not define "limited partner" and was enacted before the creation of LLCs and LLPs.
  - Therefore, there is confusion on how the exclusion for a limited partner's distributive share applies to LLC members and partners in an LLP.
    - It is unclear from the statute or regs whether the exclusion applies to LLC members because they are neither general nor limited partners, but generally benefit from limited liability under state laws.
  - Accordingly, there have been proposed regulations and litigation which address this issue.

# SE Tax: 1997 Proposed Regulation

- In 1997, the IRS proposed Regulations § 1.1402(a)-2 regarding the computation of net earnings from self-employment. The regulation attempted to distinguish earnings attributable to a taxpayer's services from a capital investment.
- The proposal defined "limited partner" by exclusion. A limited partner is one who does not (1) have personal liability for the debts or claims against the partnership; (2) have authority to contract on behalf of the partnership; **or** (3) participate in the partnership's trade or business for more than 500 hours during the taxable year.
- The proposal also included exceptions for individuals holding classes of interest that are substantially held by "limited partners" within the above meaning.
- However, the proposal specifically provided that a service partner in a service partnerships may not be a limited partner for the purposes of IRC § 1402(a)(13) unless they only provide a de minimis amount of services.

# SE Tax: *Rankemeyer*

- Some LLC members and partners of LLPs have taken the position that their distributive shares of income from an LLC or LLP that is in the business of performing services are not subject to self-employment tax.
- *Rankemeyer* and his two partners were tax attorneys operating a Kansas LLP. He tried to exclude his earnings from self-employment tax (among other issues).
- Because the statute does not define "limited partner," the Tax Court considered legislative history and congressional intent.
- The court held that "The legislative history of IRC § 1402(a)(13) does not support a holding that Congress contemplated excluding partners who *performed services for a partnership in their capacity as partners* (i.e., acting in the manner of self-employed persons), from liability for self-employment taxes."
- Functionally, a "limited partner" is someone who invests but does not otherwise contribute to the business.
- The court held that a partner must generally include the partner's distributive share of income (which includes fees for providing services) in calculating their net earnings from self-employment, unless an exclusion applies.

# SE Tax: *Castigliola*

- Lawyer-members of a PLLC paid self-employment tax on their guaranteed payments, but not on their distributive shares of the firm's profits.
- Discussing *Rankemeyer*, the Tax Court stated that the meaning of "limited partner" is not confined solely to the limited partnership context.
  - *See also Joseph v. Commissioner*, 119 T.C.M. (CCH) 1426, T.C. Memo. 2020-65 (applying *Rankemeyer* to the members of an LLC).
- The relevant inquiry is whether the person claiming the IRC § 1402(a)(13) exemption held a position functionally equivalent to that of a limited partner in a limited partnership – *i.e.*, they did not participate in controlling the business.
- Here, the lawyer-members all managed and controlled the business so they could not exclude any part of their distributive shares.

# SE Tax: Case Law Takeaways

- Liability for self-employment tax depends on the partner's level of involvement – generally not the partnership's organizational structure or the partner's protection from claims against the entity.
- To qualify for the exclusion, the level of involvement must be minimal.
  - "[A]n interest other than a limited partner interest [can] be treated as such for purposes of that section *only if the holder is merely a passive investor in the entity* who does not actively participate in the entity's business operations."
- The *Castigliola* court also noted that the definition of "limited partner" is based on the structure of an LP, and LPs are required to have at least one general partner. This implies that it would be impossible for all of an entity's members to utilize the IRC § 1402(a)(13) exception.

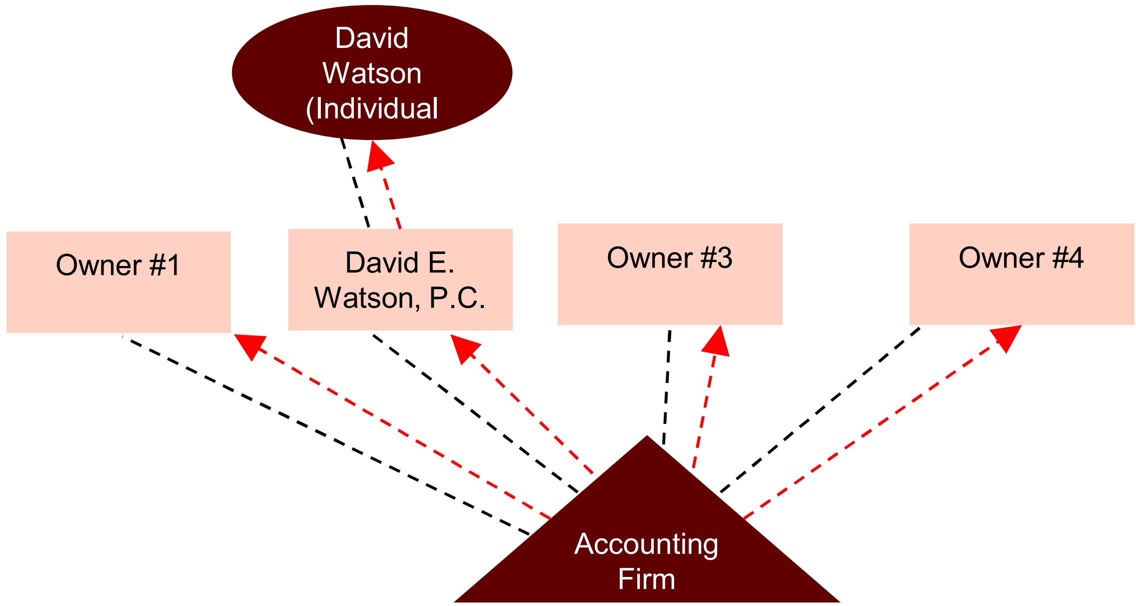
# SE Tax: S Corps

*Watson* (8th Circuit, 2012)

$24,000 salary (FICA)

$200,000 distributions (no FICA)

8th Circuit agrees with IRS expert re: deemed salary

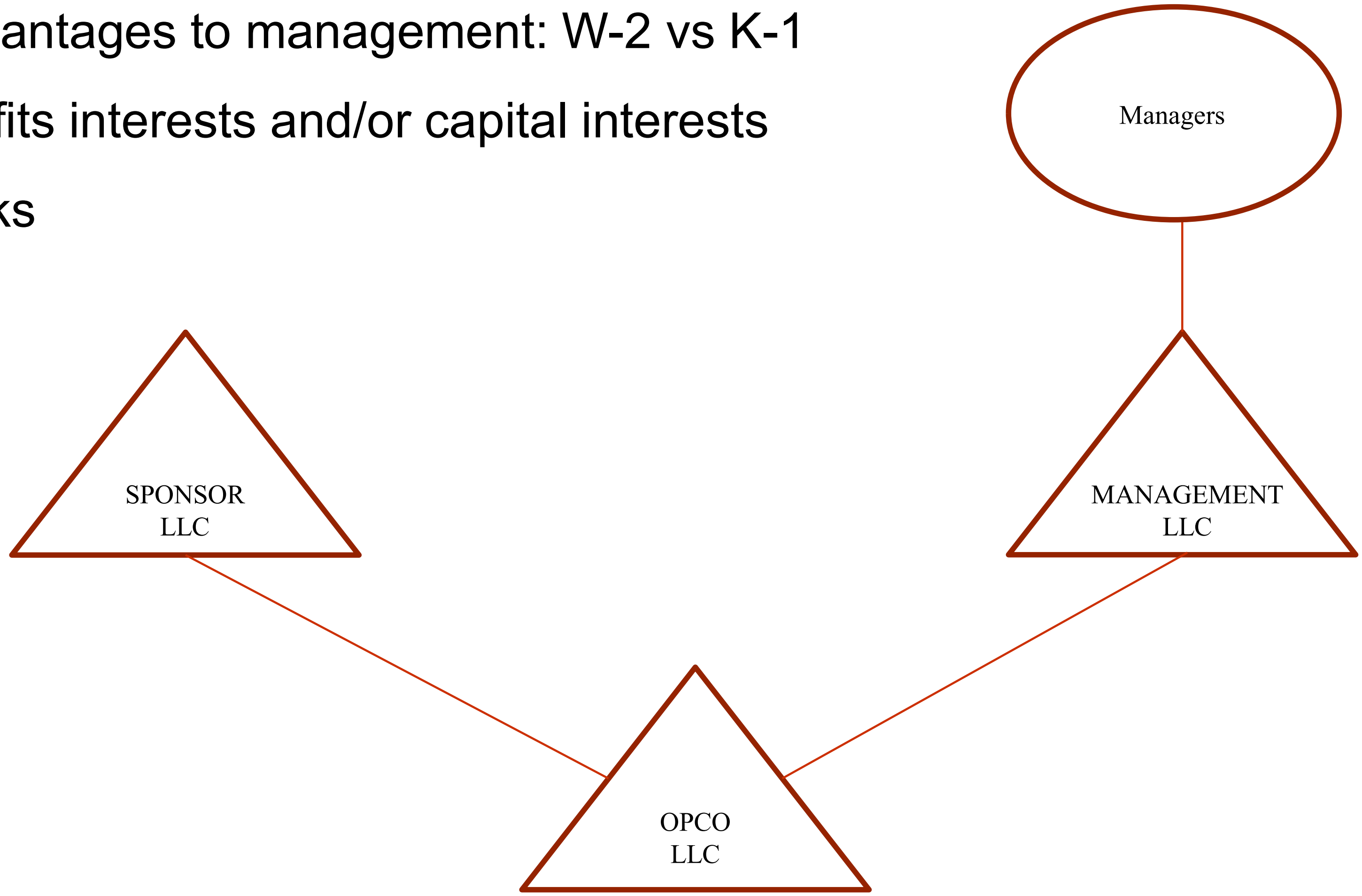



FICA Savings; Comparison to LLC:

- Active LLC member pays employment taxes on all LLC's profits *(including self employment taxes)*

# SE Tax: Management LLC

- Advantages to sponsor: cap table, liability, control
- Advantages to management: W-2 vs K-1
- Profits interests and/or capital interests
- Risks



QUESTIONS?

Thank you for attending!