



December 19, 2019

The Honorable David J. Kautter
Assistant Secretary for Tax Policy
Department of the Treasury
1500 Pennsylvania Avenue, NW
Washington, DC 20220

The Honorable Michael J. Desmond
Chief Counsel
Internal Revenue Service
1111 Constitution Ave, NW
Washington, DC 20224

Ms. Holly Porter
Associate Chief Counsel
Passthrough & Special Industries
Internal Revenue Service
1111 Constitution Ave, NW
Washington, DC 20224

RE: Comments on Proposed Regulations Concerning Allocation Based Upon Gross Receipts of Eligible Terminated S Corporations under Section 1371(f) of the Internal Revenue Code ([REG-131071-18](#))

Dear Messrs. Kautter and Desmond, and Ms. Porter:

The American Institute of CPAs (AICPA) appreciates the efforts of the Department of the Treasury (“Treasury”) and the Internal Revenue Service (IRS) in developing and issuing proposed regulations regarding eligible terminated S corporations (ETSC) under section 1371(f)¹ (the “Proposed Regulations”).

The below comments are in addition to the suggestions and [comments](#) the AICPA previously submitted on August 14, 2019, regarding guidance on adjustments attributable to conversions from S Corporation to C Corporation under section 481(d).

Overview

In general, section 1371(f) provides that distributions of money made by an ETSC are sourced either partially or entirely from any remaining balance of the accumulated adjustments account (AAA) of the ETSC.

On November 7, 2019, Treasury and the IRS released proposed regulations that describe how taxpayers are to determine the amount of a distribution made by an ETSC that is sourced from

¹ Unless otherwise indicated, references to a “section” are to a section of the Internal Revenue Code of 1986, as amended (the “Code”), and references to a “Treas. Reg. §” are to the Treasury regulations promulgated under the Code.

AAA and how much is sourced from the historical accumulated earnings and profits. We support the approach taken and agree that the proposed regulations accomplish Congress's objective of easing the transition from S corporation status to C corporation status.

In addition to providing rules regarding distributions by an ETSC, the proposed regulations remove the limitation in Treas. Reg. §1.1377-2(b) that the distribution of money during a post termination transition period (the "PTTP") only qualifies under section 1371(e) to the extent made to shareholders that were shareholders on the date the former S corporation terminated its S corporation status (the "No New Shareholder Rule"). The preamble indicates that this change was made because both section 1371(e) and section 1371(f) are intended to ease the transition from S corporation status to C corporation status. We also support this change as it will ease the transition and simplify the administrative complexity associated with the No New Shareholder rule currently in Treas. Reg. §1.1377-2(b).

Recommendations

The AICPA suggests the following recommendations to the Proposed Regulations.

1. Clarify that the status of an ETSC and the AAA are attributes that transfer under section 381 in order for the enjoyment of the benefits of section 1371(f) following certain transactions, such as reorganizations or liquidations.
2. Create a new PTTP that will equal the 120-day period beginning on the date the Proposed Regulations are finalized.
3. Confirm that the PTTP and ETSC rules apply to an S corporation without earnings and profits (E&P) at the time that its S election is terminated.

Analysis

Treasury Reg. § 1.1377-2(b) provides that a PTTP can apply to a C corporation that acquires the assets of an S corporation in a transaction to which section 381(a)(2) applies. Clarifying that the ETSC status and AAA of an ETSC are attributes that continue under section 381 is a logical extension of the regulation addressing the PTTP rules.

As indicated by Congress and acknowledged by Treasury in the preamble to the proposed regulations, both sections 1371(e) and 1371(f) are intended to ease the transition from S corporation status to C corporation status. Eliminating the No New Shareholder Rule only for terminations that occur after the issuance of the proposed regulations (the preamble permits taxpayers to rely on the Proposed Regulations as modified for PTTP distributions) disadvantages S corporations that terminated more than one year prior to issuance of the Proposed Regulations compared to those entities that terminated within such period. Accordingly, creating a new 120-day PTTP beginning the date of publication of the final regulations under section 1371(f) would treat all terminated S corporations equally.

Also, we request confirmation that the PTTTP and ETSC rules apply to an S corporation without E&P at the time that its S election is terminated. Under section 1366(b), an S corporation without E&P is not subject to the distribution rules relating to AAA found in section 1366(c).

The AICPA is the world's largest member association representing the CPA profession, with more than 429,000 members in the United States and worldwide, and a history of serving the public interest since 1887. Our members advise clients on federal, state and international tax matters and prepare income and other tax returns for millions of Americans. Our members provide services to individuals, not-for-profit organizations, small and medium-sized businesses, as well as America's largest businesses.

We appreciate your consideration of these comments and welcome the opportunity to discuss these issues further. If you have any questions, please contact Robert Keller, Chair, AICPA S Corporation Taxation Technical Resource Panel, at (504) 584-1030 or rkeller@kpmg.com; Eileen Sherr, AICPA Senior Manager – Tax Policy & Advocacy, at (202) 434-9256 or Eileen.Sherr@aicpa-cima.com; or me at (612) 397-3071 or Chris.Hesse@CLAconnect.com.

Sincerely,



Christopher W. Hesse, CPA
Chair, AICPA Tax Executive Committee

cc: The Honorable Charles P. Rettig, Commissioner, Internal Revenue Service
Mr. Thomas A. Barthold, Chief of Staff, Joint Committee on Taxation
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