



February 26, 2020

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

RE: Additional Comments on Proposed Regulations Concerning Eligible Terminated S Corporations under Section 1371(f) ([REG-131071-18](#))

Dear 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 sections 1371(e) and (f).¹

The below comments provide additional information to Treasury and the IRS regarding the second recommendation in our previously submitted December 19, 2019 [comment letter](#) on the proposed regulations (i.e., to create a new post termination transition period (PTTP) that will equal the 120-day period beginning on the date the proposed regulations are finalized).

Overview

The proposed regulations² remove the limitation in Treas. Reg. § 1.1377-2(b) which provides that the distribution of money from the entity’s accumulated adjustments account (AAA) 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 to the proposed regulations 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 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).

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.

² See Prop. Reg. §1.1377-2, REG-131071-18.

Recommendations

As indicated in our December 19, 2019 letter, the AICPA recommends that Treasury and IRS create a new PTTP that will equal the 120-day period beginning on the date the proposed regulations are finalized (i.e., for those S corporations which are impacted by the “No New Shareholder Rule” with respect to distributions under section 1371(e)).

Although not the focus of this letter, we also continue to urge IRS and Treasury to provide clarity on related issues. Specifically, in our recent letter, we recommended issuing guidance providing confirmation that (1) the status of an ETSC and the AAA are attributes that transfer under section 381 in order to realize the benefits of section 1371(f) following certain transactions (such as, reorganizations or liquidations), and (2) 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

1. Sound and Effective Tax Policy

The preamble to the proposed regulations discusses in multiple instances that the reason for enactment of section 1371(f) was to ease the transition from S to C corporation status.³ Below are some of those instances:

“Congress enacted section 1371(f) to ease the transition from S corporation status to C corporation status...” and, “In enacting section 1371(f), Congress determined that “it is important to provide rules to ease the transition from S corporation to C corporation for the affected taxpayers” because, based on the Tax Cuts and Jobs Act (TCJA) revisions to the Code, “taxpayers that previously elected to be taxed as S corporations may prefer instead to be taxed as C corporations.” H. Rept. 115-409, at 245 115th Cong. 1st Sess., (Nov. 14, 2017) (House Report).”

In its explanation for removing the “same shareholder rule,” Treasury stated the following:

“Because the rules pertaining to the PTTP and to the ETSC period serve the similar objective of easing the transition from S corporation status to C corporation status, the Treasury Department and the IRS have determined that these rules regarding newcomers should be consistent. Therefore, based on the rationale for rejecting a no-newcomer rule for the ETSC period ...the Treasury Department and the IRS have determined that a no-newcomer rule should also not apply to the PTTP.”

Similarly situated taxpayers should have the tax laws apply to them equally. Former S corporations that failed to distribute the balance of their AAA account because of the No New Shareholder Rule should be given an opportunity to distribute those amounts under the same terms as S corporations distributing AAA after the issuance of the proposed regulations.

³ Preamble to REG-131071-18, 84 FR 60011, *et seq.*

Additionally, the preamble appears to indicate that Treasury recognizes that the previous No New Shareholder Rule was too expansive in scope, and by removing it, the proposed regulations properly reflect legislative intent. A regulatory change regarding the elimination of the No New Shareholder Rule, therefore, should apply to taxpayers who relied on the previous rule to their detriment. Accordingly, creating a new 120-day PTTP beginning on the date of publication of the final regulations under section 1371(f) would treat all terminated S corporations equally.

2. *Regulatory Determination under Section 1377 and Effective Tax Administration*

An additional approach to creating a new 120-day PTTP for previously terminated S corporations is the Secretary of the Treasury (“the Secretary”) administratively deeming a determination under section 1377(b)(1)(C) of disqualified S corporation status by issuance of a notice. The notice would affirmatively acknowledge the termination of any S corporation that terminated S status prior to issuance of the proposed regulations.

The notice could further provide that the former terminated S corporation (and any successor corporation to such former terminated S corporation) could agree with the Secretary’s acknowledgement of termination of S status by filing Form 5452, *Corporate Report of Nondividend Distributions*, on the same day as any distribution of any remaining AAA balance to its shareholder,⁴ thereby satisfying section 1377(b)(2)(B)’s agreement requirement. This “automatic consent” of administratively deeming failed S corporation status between the Secretary and the previous S corporation would ease tax administration of this newly created PTTP and benefit S corporations that previously terminated before issuance of the proposed regulations. This approach would allow the S corporation to affirmatively agree and file if the S corporation desires to benefit from the newly created PTTP.

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 Rob Keller, Chair, AICPA S Corporation Taxation Technical Resource Panel, at (504) 584-1030 or rkeller@kpmg.com; Alexander Scott, AICPA Senior Manager – Tax Policy & Advocacy, at (202) 434-9204 or Alexander.Scott@aicpa-cima.com; or me at (612) 397-3071 or Chris.Hesse@CLAconnect.com.

⁴ Provided the distribution is made within 120 days of the publication of the notice in the federal register.

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Sincerely,

A handwritten signature in blue ink that reads "Christopher W. Hesse". The signature is fluid and cursive, with a long horizontal stroke at the end.

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

cc: Mr. Samuel P. Starr, Special Counsel to the Associate Chief Counsel, Office of Associate Chief Counsel (Passthroughs & Special Industries), Internal Revenue Service
Mr. Michael Gould, Attorney, Office of Associate Chief Counsel (Passthroughs and Special Industries), Branch 3, Internal Revenue Service
Ms. Aglaia Ovtchinnikova, Attorney, Office of Associate Chief Counsel (Corporate), Branch 2, Internal Revenue Service