S Corporation Shareholder Stock Basis & Bona Fide Shareholder Debt

(edited transcript)

Susan Kerrick: Thank you. Today, we're going to talk about S corporation shareholder basis. We're actually going to talk a little bit about stock basis and debt basis. I know there was another presentation that was done dealing with stock basis, and so I modified my – presentation quite a bit in order to not do, be quite so duplicative. So, hopefully, I won't disappoint. But, as he indicated, my name is Susan Kerrick. I've been with the Internal Revenue Service for 32 years, and the last 15 years I've had the opportunity being the national S Corp specialist and , um, loved every minute of it, so, but, you know, as a specialist, a lot of times people will come to me and they'll ask me, "Well, what are the top issues for an S Corporation?" and I tell them, "The number one issue is basis, the number two issue is basis, the number three issue is basis." Basis, even though it's not an S Corp issue, it's a shareholder issue, it's what we see most. Whether it be distributions in excess of basis, losses claimed in excess of basis, the issue of whether the debt basis is really, um, valid, but debt basis, whether there's gain on –

loan repayment, and the number one problem is basis is not tracked. Tracking basis in itself is not really that complex, but usually what happens is, at least when we come out and do an audit, we ask for a basis computation, and we get “the look.” Everybody knows “the look.” You guys have seen “the look.” They don't know what basis is. They have no clue what basis is, um, and if you have a client that's been an S Corp for ten years, it's not an easy task to determine what basis is. But, if you have a new client and he has a new S Corporation, if you start tracking basis from day one, it's not that complex. So, hopefully, at the end of this presentation, you'll recognize that it's very important to track basis, and you can encourage the shareholders to at least come up with what their initial basis is.

So today, we're going to identify the three shareholder loss limitations, and, again, there's three shareholder loss limitations. Um, basis is just one of them. We're going to define when shareholder has debt basis. We're going to identify case law factors used to establish when debt basis is bona fide. We're going to discuss transactions that would not qualify as bona fide shareholder debt, and we will discuss transactions that may qualify as bona fide debt. You know, I talked about basis being the most important issue or the most frequent issue that we see with an S Corp. If I eliminate basis, the most important issue I see from an income tax standpoint is that of unreported income, or diverted income. Most S Corporations are closely-held entities.

Usually, there's one or two shareholders, often husband and wife, and if there's more than one or two shareholders, it's usually family members, and we've seen situations where the shareholder will have income from the S Corporation and it won't, it's like the S Corp is not making very much money, and the amount of money that they pay the shareholder, it's really not much. So we'll have shareholders that are making $20,000.00 a year through their pass-through income and through their wages, and despite the fact that it happens for multiple years, they still manage to live in a house ten times the size of mine. I think it's either magic or something is wrong, so I've always, you know, whenever I see that situation, I ask a lot of questions because I want to know how to do that. How can I not make money and still live in the huge house? Every – once in a while, their debt is real high or they have a one-year bad situation but, if it's multiple years, it's got to be more than magic.

So there's two main reasons for electing S Corp status, and they're both tax-motivated reasons. One is to avoid the double taxation on distributions. With a C Corp, the C Corp earns, and, when they distribute their profits to the shareholders, the shareholders will, uh, have to pay dividend income, so it's taxed twice. On an S Corp, if it earns income and makes a distribution to its shareholder, it's generally not taxed twice. The second reason is it allows losses to pass through to its shareholders, but Congress placed limits on that, and that's really the focus of the conversation today. So, an S Corporation is a pass-through entity, so income, loss, deduction all pass through to the shareholder and are taxed at the –shareholder level.

A shareholder receives a K-1. The K-1 now is formatted very similar to a W-2, and, unlike a W-2, everything that's on the W-2 you generally know where it goes on the 1040. You know where the wages go. With a shareholder, they get a K-1. The K-1 will tell them the income items, and those will generally go on the 1040 in the appropriate line items. If it's interest income, it goes in Schedule B. If it's ordinary income, it goes on Schedule E; 179 will go on Schedule E. On the other hand, if it's a loss, if it's, a non-dividend distribution, the K-1 doesn't tell you what goes on the 1040. So, if a K-1 shows that the shareholder –

receives a $10,000.00 non-dividend distribution, what goes on the 1040? Zero, $10,000.00, or, "I'm just not sure," and the answer is, "I'm not sure. What do I need to know?" I need to know the shareholder's stock basis, not their debt basis but their stock basis. If the shareholder has no stock basis, then it's a capital gain on Schedule D. If the shareholder has stock basis, it may not go on the 1040, or if the shareholder only has part stock basis, it's a sale of stock on Schedule D. The amount in excess of stock basis is reportable as a capital gain.

The K-1 could reflect an ordinary loss of $15,000.00, charitable contributions of $2,000.00, or a $6,000.00 179 deduction. What goes on the 1040? It's not – automatically what's on the K-1. The first thing you need to know is whether the shareholder has adequate stock and/or debt basis to claim those losses. If they have no stock and debt basis, nothing goes on the 1040. Again, it's not automatically what's on the K-1. There are three shareholder loss limitations. The first is the stock and debt basis. Losses should not be reflected on the –

1040 if there's not adequate stock and debt basis. If there is adequate stock and debt basis, then the next limitation is at-risk. Now, at-risk does not –Generally, if you have adequate stock and debt basis, you also have at-risk. There's a few situations where you can actually have stock and debt basis and not have at-risk. The one I see most is let's say that I own an S Corp, I'm 100 percent shareholder, but I have an employee who is real good and I want him to be able to buy into my company. My company is worth – I want to sell him 20 percent of the company, um, and I think the fair value is $500,000.00. My employee agrees that my company is worth it, and he's willing to pay $500,000.00 for my company, but the cash isn't there right now. So he decides he's going to buy it on the installment – method, so he and I agree that he'll make installments on that $500,000.00, so the $500,000.00 will be basis, the amount of the contract that he agrees to pay me, but he will not be at risk because he's borrowing it from another shareholder. That installment agreement is paramount to borrowing from the other shareholder, so although he has basis, he's not at risk. So he's at risk in the amount he pays on that installment sale, and so as he pays the installment sale, he will be at risk. So, after, if he's, at, if there's any amount that was contributed or loaned to the corporation and there's amounts that are not at risk, those amounts go on Form, or 6198, and then the 6198 will determine the deductible amount.

The deductible amount then we have to determine whether it's a passive activity or not.

If it's a rental, it's generally passive. If it's a business activity that the, um, the shareholder doesn't materially participate, it can also be passive. If it's a passive activity, the loss goes on Form 8582 to determine the allowable amount of the loss that's, um, deductible in the current year. It will depend on whether the shareholder has other passive income.

So each year, the shareholder needs to know: the amount of their stock basis, so that they can determine if the distributions are taxable; the amount of their debt basis, to determine whether they have loss or deduction items that they can take or that they need to limit. They need to know the suspended losses due to stock and debt basis, the suspended losses due to at-risk, and the suspended losses due to passive activity limitations. They're different.

How they're handled on a sale makes a big difference. If I have suspended losses of $300,000.00 due to stock and debt basis, and I sell my stock for $500,000.00, how much of the $300,000.00 is allowable, and the answer is none. On Schedule D, I would show my sales price of $500,000.00, I would show my basis as zero, and I would show my gain of $500,000.00. That gain does not increase basis, it does not trigger those $300,000.00 suspended losses due to basis. You can never claim losses in excess of stock and debt basis. On the other hand, suspended losses due to at-risk, in order to claim those losses, first they had to have basis, but if they had suspended losses of $300,000.00 due to basis –

and they have a gain on the sale of the stock, they can actually take the suspended losses up to the reportable gain.

The rules are different, and a suspended loss due to passive activity losses, they're triggered in a qualifying disposition. So each of the rules are very different, and so you need to be able to keep the pools separate. Don't automatically assume that all suspended losses are triggered when they're sold. That only applies to the passive activity losses.

So, with debt basis, debt basis is not used for distributions, but if a shareholder has losses that exceed their – stock basis, they then look to debt basis: 1366(d) states that losses are allowable up to the amount of the shareholder's adjusted basis of any indebtedness in the S Corp to the shareholder. The S Corp shareholder does not get basis in third-party debts of the equity. It's not a partnership. A partnership, they actually get allocated, um, liabilities as part of their basis. An S Corp is considered a separate legal entity. The basis of the entity does not increase the shareholder's debt basis. First, we increase, first, we reduce stock basis, then we reduce debt basis. If there's a net – increase for a given year, and that means there's more income than loss, and deduction items and distributions, that means we increase debt basis before stock basis.

Keep in mind that when debt basis is reduced, let's say that the corporation, the shareholder loaned the corporation $100,000.00. When debt basis is reduced, the corporation still owes the shareholder $100,000.00. If it's repaid when there's reduced basis debt, it results in gain to the shareholder.

So the first question we have to ask is what qualifies it as indebtedness to the shareholder? This use, this used to be the most controversial area of law. There are a lot of court cases on it, and the court cases seen to flip-flop a lot. The standard – they used to use was, under the prior rules, was the shareholder must experience an actual economic outlay that made the shareholder poorer in a material sense. Clear as mud. The shareholder must experience an actual economic outlay such that the shareholder is poorer in a material sense, and it was the standard created by the courts, and the courts didn't always agree what that meant. So there would be cases with very, very similar fact patterns, and sometimes the taxpayer was allowed basis. Other times, they were not allowed basis. So Treasury and the IRS said, "You know, we don't really think that that standard that's unique to S Corps is necessary. We really would like to change the standard," and so they proposed a regulation in June of 2012, and it was finalized in July –of 2014, and it basically provides that a shareholder obtains basis in indebtedness if the S Corp owes a bona fide debt directly to the shareholder. Now it's a lot clearer now, isn't it? So what is bona fide debt?

So indication that the debt is bona fide is that it's a written instrument. On an S Corporation, a closely-held entity, do we always have written instruments? No. What happens? The corporation is going along and it needs cash. Guess where it gets its cash sometimes? From the pocket of the shareholder. Is there a problem if the shareholder puts some money in his corporation and it's not written by a written instrument? No. Does it mean it's not bona fide debt just because the shareholder did put the money into the company? No. So the fact that there's not a written – instrument doesn't make it not bona fide. But, if there is a written instrument, it's an indication that it is bona fide debt according to the case law factors. If there's a stated interest rate, that's an indication that there could be bona fide debt. The fact that there isn't doesn't necessarily make it bad. Maturity date, enforceable debt under state law, these are all factors that could help with the argument that the debt is in fact bona fide. A reasonable expectation of payment, credit~~,~~ or remedies. Those are, again, these are potential things that can help support that the debt is bona fide. One of the areas, repayment or other conduct that indicates that parties uphold the term of the debt.

Well, as you know, you prepare a tax return one year, we don't come to audit for a year or two, so generally we can kind of see, "Well, what's happened since then?"

Never got repaid? Maybe it's not bona fide debt, or maybe it did get repaid. "How was it structured? What exactly happened here?" and those factors may help us determine whether the debt is bona fide. There's additional factors in Notice 94-47, but it's a facts-and-circumstances issue. The issue of bona fide debt is defined outside of S Corps. It's not unique to S Corps, so bona fide debt is our new standard.

We did go through old court cases and, you know, the ones that had the actual economic outlay standard, they often commented that the debt was not bona fide, and when they allowed it, they indicated that debt was bona fide. So the court cases that were –

in the past under the different standard, a lot of them still apply.

So, if an S Corp goes out and borrows $500,000.00 from the bank, does this give the shareholder basis., and the answer is no. Is there bona fide debt between the shareholder and the S Corp? No~~.~~ It's between the bank and the S Corp, so the shareholder does not get basis in third-party debt of the entity. Often, I see where the shareholder wants to tell the IRS, "I have basis in this debt," and if for some reason the S Corp isn't doing well and the S Corporation folds, they want to tell the bank, "Hey, I'm a separate legal entity. I don't have to pay that." You can't have it both ways.

If the corporation's debt that it borrowed from the bank of $500,000.00, the shareholder guarantees it, that does not give the shareholder debt basis. The shareholder may never pay it. So a loan guarantee acting as a surety, accommodating party, or similar capacity does not give rise to indebtedness. I know agents come to me all the time and they call it different things. They always come up with different names, and it's like, "Oh, that makes it more binding to the shareholder." It's still a loan guarantee even if it's called something else. The shareholder isn't paying it, so it's not bona fide debt. Again, there's bona fide debt between the bank and the corporation, but not between the shareholder and the corporation.

What if the shareholder makes a payment on the loan guarantee? So we'll say the shareholder made a $20,000.00 payment on the loan guarantee. The corporation didn't have the cash, so the shareholder made a payment on the loan guarantee. Under the doctrine of subrogation, the shareholder gets basis of the $20,000.00. The shareholder is stepping in the shoes of the corporation for the amount they paid, the $20,000.00, so the amount they paid of $20,000.00 they get basis. If the loan was $500,000.00, the $480,000.00 they still don't have basis in, but to the extent they make a payment, they now have bona fide debt between the S Corp shareholder and the corporation.

In *Montgomery v. Commissioner*, there was actually a judgment imposed as a result of the shareholder's loan guarantee. The shareholder still had not made any payments. The shareholder did not become the primary obligor. The corporation is still the primary obligor, and there was a, the ruling was that it did not create basis between the shareholder and the S Corporation since there was no payment. So even though there was a judgment and the bank is looking for the shareholder to make the payment, until they make the payment, they didn't get basis.
I see this a lot: co-making and co-borrowing. You look at the contract. It says, "ABC Corporation agrees to pay, and Sue Kerrick agrees to pay the bank back." Co-making arrangement does not give the shareholder basis. There is bona fide debt between the corporation and the –

bank, and there's bona fide debt between the shareholder and the bank, but there is not bona fide debt between the shareholder and the corporation. I had a case one time where the accountant went to the attorney and says, "I want the shareholders to be personally liable for this debt," and the attorney said, "I can't make the shareholders any more personally liable for the debt." They are personally liable for the debt, no argument, but they don't get debt basis. If they make a payment, then they get basis.

We see back-to-back loans in the S Corp arena quite often. A back-to-back loan is where one person borrows money from another and lends the, uh, from one party and then lends it to another. In the case of an S Corp and the shareholder –the shareholder usually borrows money and then lends it to the S Corp. We're going to do a couple examples of that.
Shareholder goes to the bank and borrows $500,000.00. It then loans it to the S Corporation. So it's a third-party debt, independent third-party, and it's not short-term. This will generally give the shareholder basis, and *Gilday v. Commissioner* confirms this. I had a case one time where the shareholder used his house as collateral. He was the one who personally borrowed the money. The company folded, the shareholder lost his house, but he did get basis. It might have been the best thing for them to do but – he did get basis.

We see often on audit the shareholder does this: they go ahead, and (we'll make the numbers nice and round so I can do the math), they'll go out and they'll borrow from the bank $100,000.00 and they'll put it in the S Corporation. The S Corporation loses some of the money, so they're allocated losses of some $80,000.00. So now, on the balance sheet of the corporation it says, "Loans from shareholder, $100,000.00." The corporation still owes the shareholder the $100,000.00 even though their basis is now $20,000.00. The corporation is making the payment on the bank loan, even though it came from the bank to the shareholder and then to the corporation. Well, when there's a payment on the bank loan –

by the corporation, or if they make a distribution, or a repayment on that loan to the shareholder, it's a repayment of reduced basis debt, so we said that the debt basis was reduced by $80,000.00, or 80 percent, and the basis is now 20 percent. So, if they make a payment of $1,000.00, 80 percent or $800.00 is going to be a taxable gain. If there's no formal note, then it would be ordinary income to the shareholder. If there is a formal note, it's a capital gain to the shareholder, so be careful on how you structure it. Shareholder does get basis if they're personally liable on the debt for money that they put into their corporation, but you can have to worry about gain on loan repayment. One time, I had a, uh, case where the agent had called me up and she said, "Well the taxpayer said –

um, he did not want to have gain on loan repayment so he decided he would not reduce his basis by those losses." Well, the law says that first stock is reduced, then debt basis. It doesn't say the loss, that loss is reduced stock basis and if you feel like it, you then reduce debt basis. So debt basis is reduced whether you claim the loss or not, whether you get current-year benefit. So he had reduced basis debt whether he liked it or not and, unfortunately, also had gain on loan repayment. I think the year that the loss was claimed was open by statute, so he could get it fixed. But, if there hadn't been, there wasn't much the agent could do.

We often see where an S Corp shareholder has more than one corporations. For the purposes of our discussion, let's assume they have two –

corporations. One we're going to call Profitable – it has cash – one we're going to call Loss – it needs cash. If Profitable loans money to Loss, does that give the shareholder basis, and the answer is no. Is there, if Profitable loans money to Loss, on the balance sheet of Profitable, it will say, "Due from affiliate," and on the balance sheet of Loss it's, "Due to affiliate." There's no bona fide debt between the shareholder and the S Corporation. If Loss company goes under, one would expect that Profitable may be able to claim a deduction, depending on the facts and circumstances. I've seen situations where the shareholder said they had basis in Loss, claimed the losses that were allocated, Loss entity folded – and Profitable still took the bad debt. So, if it was an S Corp, if they both were S Corps, they claimed the same loss twice. Magic.

So what if we change the facts? If Profitable goes ahead and loans it to the shareholder and then the shareholder takes that money and loans it to Loss company, could that give the shareholder basis? One of the things about the regulations, they never say yes, but they say, "May."

So based on the facts and circumstances, one must determine if there's bona fide debt from S Corp owed to the shareholder. If there's bona fide debt, debt basis is allowed, so the Reg says, "It may give them basis."

Again, we would not expect on the books on Profitable to say, "Due from affiliate," if it was a loan to the shareholder. We would not expect to see "Due to affiliate," on Loss. We would expect it to say a loan to and a loan from shareholder. A lot of times, what happens is they try to restructure it on audit, and it doesn't work. Usually, we go to the books and records and then we say, "Well, this is how you've booked it here, and you've booked it here inconsistently. It doesn't make sense." So one of the big factors we determine on the facts and circumstances is how is it being handled by each entity, and, again, the main issue is if the company folds tomorrow, who's going to be out the money?

If it's going to be the shareholder, it should be bona fide debt. If it's the other company, maybe it shouldn't be, but I definitely don't want both getting the benefit, getting two benefits. So, if they book it and account for it properly, they may get basis.
So, after this presentation you decide you're going to restructure these related-party debts: will that give basis? So let's say Profitable had originally loaned money in 2012 to Loss, and so in 2016 we say, "Okay, let's go ahead and distribute that note to shareholder, and then shareholder will then have the note between shareholder and Loss, and they'll cancel the note between Loss and Profitable." Can that give us, um, basis? Treasury Reg example three says, "If there's bona fide debt between the – corporation and the shareholder, it may give you basis." Again, it's facts and circumstances. What I'm looking at is how did Profitable handle it, how did Loss handle it, and are they treating it consistently? What was the flow of the cash? How was the flow of the accounting? It needs to be consistent.

In *Maguire v. Commissioner*, there was a distribution made from Profitable followed by a contribution to Loss, and prior to, under the old standard of actual economic outlay, there was at least one court decision where they made a distribution of a note, and that distribution of a note to some of the, some of the owners was actually a taxable – distribution, and then it was a contribution from, to the shareholder, or a loan to the Loss company from the shareholder, and the court said it didn't give them basis, and their logic was the shareholder received something. So he didn't have an actual economic outlay, he received a distribution, and so we had always told agents that if the corporation actually made a distribution, it's kind of up in the air on whether or not we would give them basis. But what the court didn't say is why would, if the, if a distribution is made by Profitable, Profitable is less profitable now. Their assets are going down by the amount of that distribution, so why wasn't that decrease in the asset value some type of economic outlay? But we said that using the old court case that we could probably argue that it did not, that they did not get basis.

Though it never went to court, and I think the issue was is a lot of agents didn't raise it because they didn't see any problem with it, but in *Maguire* they actually indicated that, "Hey, they reduced the basis of Profitable, they increased the basis of Loss," they saw no concern with that. Sounds good to me.

Circular flow of funds. Generally, funds start with one entity, they're lent or distributed to other persons and/or entities, and end up with the original entity. They may provide the shareholder debt basis. When the transactions lack substance, or the shareholder is merely a conduit, the shareholder is not allowed debt basis. The preamble of the regs basically discussed the circular flow of funds. They didn't say, "No, they can't – work." They just said that, "Hey, if it doesn't make sense, they don't work," and we're going to, there were two court cases in particular.

Oren v. Commissioner. *Oren v. Commissioner* restructured the investment where we had Profitable and Loss. Loss had lost money, but they already had the cash. They had third-party debt. So they had the cash in the, in Loss company. They didn't really need the cash at the moment, but the shareholder needed basis in order to claim the losses. So, before December 31st, Profitable made a loan to shareholder, the shareholder then loaned it to Loss company, and that transaction, we said earlier, may give you debt basis. But then, after January 1st happened, guess what? Profitable got paid right back.

So the court in *Oren* said it didn't make sense, that the transaction lacked substance. The only purpose for that transaction was to create basis on December 31st. The shareholder wanted to be able to claim losses. They didn't need to infuse cash in the business, and, at the end of the day, the cash wasn't in the business, it was back on Profitable’s books. So, in *Oren*, we said that a circular flow of cash does not give you basis.

Kaplan was a very similar situation, although they made it a little more complex in structure. In *Kaplan*, they had an S Corporation, so the bank loaned money to the shareholder, so it looked more legit. It's an independent third-party who loaned the money to the shareholder. Then, the shareholder takes that –money and they loan it to Loss company, then Loss company moved the money to the shell company. The, the, all the transactions actually cleared on the same day. The money never left the bank. The collateral of the loan was the shell company's assets, which were just the cash from the loan, and if you looked at the next year, or five days later, the loan was paid back. What happened in *Kaplan* is they were going to terminate their S election. What happens to suspended losses due to basis if you terminate your S election? So long, farewell. They're gone. So, if he didn't contribute $800,000.00 to his –S Corporation, he would not have gotten basis, and those $800,000.00 in suspended losses would have been lost forever. So, therefore, they wanted to make sure that they were not lost forever.

In both of these transactions, if you took a step back and you looked at them, you recognize what they're doing. You recognize that they're manufacturing basis for a short period of time in order to claim basis. In those types of situations, the Regs did not want to, um, say that they're allowed to do a circular flow of funds, but the fact that the money does eventually go back to Profitable, in the *Oren* case, if it was a matter of years, if the, if Profitable had loaned money to the shareholder and the shareholder had loaned money to Loss because they needed the working capital –and five years later down the road the money ended up getting repaid, there's no real problem with that. So the circular flow of funds was not the problem, it was that it was a structured transaction to manufacture basis.

Usually, when we talk about stock and debt basis, the number one issue we get is, " I have a client that has been in operation for five years? What do I do? Where do I start?" and that's what agents get all the time. They have, um, taxpayers, they ask for a basis computation and they get the dumbfounded look. We ask them to at least play 20 questions, "How did you acquire the stock? Oh, you purchased it." Um, "How did you, how did – you, um, you transferred it from a Schedule C to the corporation." Once you determine your starting point, then you need to know everything there was in the S Corp that has increased and decreased basis since inception. On the balance sheet of the corporation, if the shareholder was originally the S Corp shareholder, capital stock and paid-in capital may be the starting cost of that shareholder. Now, if I borrow, if I went ahead and bought stock from my shareholder in 2015 for $10,000.00, and that corporation has been in existence for 20 years, my basis is still what I paid for it, the $10,000.00, so the balance sheet is not an indication of what basis is. But, assuming that the balance sheet was the original shareholder capital stock and additional paid-in capital is generally the cost – of the S Corporation.

All the items that increase and decrease basis also increase and decrease the triple AAA account, and so we try to reconstruct basis the best we can. We try to get every K-1 since day one, and we try to reconstruct basis, then we look to the triple AAA and what's on the balance sheet and we say, "Okay, does this reconstruction and the estimate, do they make sense?" Okay.

We do have an S Corp website on IRS.gov. You can get to it by keyword search S Corporation. I'm kind of the owner of that page. We do talk a little bit about stock basis. We do talk a little bit – about late election relief. We talk a little bit about, um, inadequate compensation, an issue we see a lot on S Corporations. Um, if you, um, the forum has asked if you have any suggestions or if there's something you would like to see out on that website, please don't hesitate to ask for it. Are there any questions? Everybody has got all the answers. Great.

[Laughter]

All right. Well, another way to think about basis is when a corporation is losing money, the question is where do you get the money to lose? Where does the corporation actually get the money to lose? If the corporation's balance sheet indicates that it's from third-party debt, chances are the shareholder does not have –basis. If the balance sheet says loans from shareholder or additional paid-in capital from shareholder, we may need to at least go back and look, "Where did they get the money?" If the shareholder doesn't have a lot of resources and they're claiming to loan significant sums to the corporation, please ask 20 questions.

We can have improper or overstated expenses that cause losses, so be cognizant of that, and, as I indicated earlier, diverted income, because these are such closely-held entities. If it's a cash business and the shareholder has opportunity, there is an occasion where money doesn't seem to hit the corporate side because it ends up in the pocket at the shareholder side. Any questions? Yes? No.

In summary, we talked about guaranteeing or co-making and co-borrowing does not give the shareholder basis. The shareholder gets basis to the extent of payments made on loan guarantee, and the key factor is you need to establish whether there's bona fide debt between the S Corporation and the shareholder.

Thank you, everybody. Have a good day.
[Applause]

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Glossary

Bona fide Debt – In order for a debt to be considered bona fide debt, the creditor/debtor must be able to show that at the time of the transaction, it had a real expectation of repayment and intent to enforce the collection of the indebtedness.

Distributions – also refers to a company's payment of stock, cash or physical products to its shareholders. ... Distribution is an allocation of capital gains and income that mutual funds generate for their investors periodically during a calendar year.

S Corporations - are corporations that elect to pass corporate income, losses, deductions, and credits through to their shareholders for federal tax purposes. Shareholders of S corporations report the flow-through of income and losses on their personal tax returns and are assessed tax at their individual income tax rates. This allows S corporations to avoid double taxation on the corporate income. S corporations are responsible for tax on certain built-in gains and passive income at the entity level.

Shareholder- A shareholder is any person, company or other institution that owns at least one share of a company's stock. Because shareholders are a company's owners, they reap the benefits of the company's successes in the form of increased stock valuation. If the company does poorly, however, shareholders can lose money if the price of its stock declines.

Stock Basis –basis is the original value of stock for tax purposes, usually the purchase price, adjusted for stock splits, dividends and return of capital distributions. This value is used to determine the capital gain, which is equal to the difference between the cost basis and the current market value.

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