

SUMMER 2023

STUDENT UPDATE MEMORANDUM

to

FUNDAMENTALS OF CORPORATE TAXATION

Cases and Materials

Tenth Edition

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FOUNDATION PRESS

2023

PREFACE

This Summer 2023 Student Update Memorandum brings *Fundamentals of Corporate Taxation* up to date by summarizing major developments since publication of the Tenth Edition in October of 2019. The Memorandum covers developments through July 1, 2023, including selected provisions of the Inflation Reduction Act of 2022, Pub. L. No. 117-169, 136 Stat. 1818, and provides our annual bipartisan overview of pending legislative proposals with potential impact on business enterprise taxation and their prospects for enactment.

Instructors who have adopted the text for classroom use may provide electronic or paper copies of all or part of the Update Memorandum to their students.

The Update Memorandum is organized to parallel the text, with cross references to chapter headings and page numbers.

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July 2023

PART ONE: INTRODUCTION

CHAPTER 1. AN OVERVIEW OF THE TAXATION OF CORPORATIONS AND SHAREHOLDERS

B. INFLUENTIAL POLICIES

Page 6:

As noted in the text, the policies underlying Subchapter C and influencing the business enterprise taxation landscape have been in a periodic (some might say “constant”) state of disequilibrium as part of a highly politicized tax legislative process. Changes usually follow a shift in the balance of power, which occurred with the 2020 elections albeit with the narrowest of margins in Congress, but enactment of major tax legislation has become virtually impossible during periods of divided government.

During his first 100 days in office, President Biden opened the bidding on a sweeping list of tax proposals that were a major piece of a broader legislative package. <https://home.treasury.gov/policy-issues/tax-policy/revenue-proposals>. Key components of the initial Biden tax plan were: (1) an increase in the corporate income tax rate from 21 to 28 percent; (2) an increase in the top marginal individual income tax rate from 37 to 39.6 percent; (3) a 15 percent minimum tax on the book income of certain large corporations; (4) taxation of long-term capital gains and qualified dividends at ordinary income rates for taxpayers with adjusted gross income of more than \$1 million; and (5) treatment of gifts and bequests of appreciated property as taxable events (with a \$1 million lifetime exclusion and an exemption for transfers to spouses). The plan also would have made major changes to the U.S. taxation of multinational businesses and increased the budget for IRS enforcement and tax administration. More targeted revenue-raising measures were aimed at partnerships and S corporations.

In the Summer 2021 update, we said:

If the Democratic members of Congress remain united (not a sure thing), many of these proposals could be enacted and take effect for taxable years beginning in 2022. Depending on the ultimate outcome, this legislative package potentially will influence future decisions on choice of entity for a business enterprise and change the tax stakes for many transactions involving corporations and their shareholders.

As the process played out, Senate Democrats were not united, with Senator Kirsten Sinema of Arizona (who later changed her party affiliation to “Independent”) opposing the

tax rate increases and Senator Joe Manchin of West Virginia objecting to the overall cost of the broader legislative package. In November 2021, a diluted version of the Biden administration's proposals narrowly passed the House as part of the Build Back Better Act (H.R. 5376). This wide-ranging legislation abandoned the corporate and individual tax rate increases and pivoted to alternative measures, such as a surcharge on high-income individuals and a corporate-level excise tax on stock buybacks. Amidst continuing political gridlock, however, the Build Back Better Act stalled and then died in the Senate.

Undaunted, President Biden in his fiscal year 2023 revenue proposals resurrected the corporate and individual tax rate increases, floated a minimum income tax on taxpayers with a net worth of more than \$100 million, refined the international tax reforms, and included a list of loophole closers many of which dated back to the Obama administration. See General Explanations of the Administration's Fiscal Year 2023 Revenue Proposals, Dept. of the Treasury, March 2022, available at <https://home.treasury.gov/system/files/131/General-Explanations-FY2023.pdf>. After prolonged negotiations to round up sufficient support in the Senate, a reworked version of the Build Back Better Act – known as the Inflation Reduction Act of 2022 – passed by the narrowest of margins and became law in August 2022. The major substantive business tax provisions were: (1) a selective 15 percent corporate minimum tax, (2) a new one percent excise tax on stock repurchases by certain publicly traded companies, and (3) a two-year extension of the Section 461(l) limitation on excess business losses. The Inflation Reduction Act also included provisions to increase funding for IRS enforcement, extend and expand various clean energy tax credits, and boost subsidies under the Affordable Care Act (a/k/a Obamacare).

As this Update Memorandum is being completed in early July 2023, the prospects for enactment of any significant tax legislation during the months leading up to the 2024 Presidential election are slim to none. This forecast has not halted the issuance of competing wish lists from the Biden administration and House Republicans. In his fiscal year 2024 budget message, President Biden continued to advocate for corporate and individual tax increases, a new minimum tax on certain wealthy taxpayers, closing of familiar loopholes, and expansion of credits for lower income workers and families. See General Explanations of the Administration's Fiscal Year 2024 Revenue Proposals, Dept. of the Treasury, March 9, 2023, available at <https://home.treasury.gov/system/files/131/General-Explanations-FY2024.pdf>. In June 2023, the House Ways and Means Committee sharpened the debate by approving a set of mostly pro-business measures consolidated into a bill branded as the American Families and Jobs Act. Among other things, the Republican tax package would halt the phase-out of 100 percent expensing under Section 168(k), suspend a controversial provision requiring amortization of research and experimentation expenses, relax the limitation on deduction of business interest, expand the exclusion from gain for sales of Section 1202 qualified business stock, pare back clean energy tax incentives, and temporarily increase the individual standard deduction (to be renamed the "guaranteed deduction") with a phase-out for higher-income taxpayers. The proposal to restore full expensing of R & E expenditures has substantial bipartisan support but only a slight chance of enactment unless the two sides agree to attach it to another bill, which

would require including an item high up on the Democrats' wish list, such as expansion of the child tax credit.

As usual, the results of the 2024 Presidential and congressional elections will have an enormous influence on the direction of future tax legislation. Significantly, the individual tax rate reductions and many pro-business provisions from the 2017 Tax Cuts and Jobs Act (except for the "permanent" reduction of the corporate income tax rate) were only temporary and are set to expire at the end of 2025 unless they are extended or made permanent. Some of the controversial revenue raisers in the 2017 legislation, such as the limit on deducting state and local taxes and the flat ban on deducting miscellaneous itemized deductions, also will expire, restoring the law as it was prior to 2018. So something will happen in 2025 even if Congress does nothing while watching the late December sunset. Its inaction (unlikely) will have economic consequences and implications for individual and business tax planning. Our only predictions are that the debate will be contentious and, unless one political party has a landslide victory in 2024, the outcome will go down to the wire.

Page 9:

The International Dimension: A Global Minimum Tax. Erosion of the corporate income tax base is a concern not only for the U.S. but also for countries around the world. In response, more than 130 countries, including the United States, recently agreed to implement major international tax changes, including a global minimum tax. OECD, Statement on a Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy (Oct. 2021). These international agreements have the potential to fundamentally alter the tax rules applicable to multinational companies. Additional details are (far) beyond the scope of a text focused on the domestic tax rules applicable to corporations and their shareholders. Nevertheless, these international tax developments may provide useful background because they could ultimately affect the behavior of corporations that operate in the U.S. and lead to changes to U.S. tax laws applicable to corporations.

C. INTRODUCTION TO CHOICE OF BUSINESS ENTITY

Page 21:

Employment Tax Considerations. The Social Security and self-employment tax wage base was raised to \$160,200 for 2023.

Recent comments from practitioners and IRS officials confirm an increased level of scrutiny of limited partners and LLC members claiming the exemption from self-employment tax. The Service appears to be focusing on the extent of the services provided by the limited partner or LLC member on behalf of the entity, consistent with the standards articulated in the 1997 proposed regulations.

D. THE CORPORATION AS A TAXABLE ENTITY

1. THE CORPORATE INCOME TAX

Page 23:

Add to the Code “skim” assignment: § 243.

Page 24:

In the fourth full paragraph, change the first sentence to: By virtue of their unique status, Section 243 provides corporate shareholders with a dividends received deduction not available to individuals.

Page 27:

The Corporate Alternative Minimum Tax. For taxable years beginning after 2022, Section 55, as amended by the Inflation Reduction Act of 2022, imposes an alternative minimum tax on “applicable” corporations, which generally are corporations (other than Subchapter S corporations, regulated investment companies, and real estate investment trusts) with average annual adjusted financial statement income for the prior three-year period of over \$1 billion. I.R.C. §§ 55(a), (b)(2); 59(k). Greatly simplified, an applicable corporation is likely to owe alternative minimum tax when 15 percent of its financial statement income is greater than its regular tax liability.

Technically and very generally, the corporate alternative minimum tax is equal to the excess of (1) the corporation’s tentative minimum tax for the taxable year, over (2) its regular tax for the year plus an anti-abuse tax levied on certain multinational corporation transactions. I.R.C. § 55(a). Tentative minimum tax is 15 percent of a corporation’s “adjusted financial statement income” for the taxable year under Section 56A, reduced by the corporation’s alternative minimum tax foreign tax credit under Section 59(l). I.R.C. § 55(b)(2)(A). Adjusted financial statement income of the corporation is the net income or loss set forth in the corporation’s “applicable financial statement” (as defined in Section 451(b)(3)), with certain adjustments. See generally I.R.C. § 56A(c). In determining the corporate AMT base, the statutory scheme provides many highly specialized rules for commonly controlled corporate enterprises, other complex structures, corporations whose financial statements include income from partnerships and disregarded entities, net operating losses, tax credits, and more. Finally, an applicable corporation is also allowed a limited tax credit for alternative minimum tax paid in prior years. I.R.C. § 53(e).

It is too soon to know for sure, but it appears likely that the new corporate alternative minimum tax will have a limited reach. The Joint Committee on Taxation staff estimates that for the 2023 taxable year approximately 150 corporations will be subject to the tax, generating approximately \$35 billion in revenue. See Staff of the Joint Committee on Taxation, Overview of the Federal Tax System as in Effect for 2023, JCX-9K-23, May 11, 2023.

PART TWO: TAXATION OF C CORPORATIONS

CHAPTER 2. FORMATION OF A CORPORATION

F. COLLATERAL ISSUES

1. CONTRIBUTIONS TO CAPITAL

Page 110:

As discussed in the text, in 2017 Congress limited the Section 118 exclusion from gross income with an amendment providing that any contribution to capital by a nonshareholder, including those made in aid of construction and any other contribution made by a customer, potential customer, governmental entity, or civic group would not qualify for the exclusion. In the Infrastructure Investment and Jobs Act (P.L. 117-58), Congress partially reversed this enhanced limitation by amending Section 118 to provide that contributions of money or other property from any person, whether or not a shareholder, to a regulated utility which provides water or sewerage disposal services will qualify as a nontaxable contribution to capital, subject to several additional requirements. This change was made to stimulate new infrastructure investments in the targeted businesses.

CHAPTER 3. CAPITAL STRUCTURE

A. INTRODUCTION

2. LIMITATION ON DEDUCTION OF BUSINESS INTEREST

Page 121:

The Service has issued final regulations interpreting the Section 163(j) limitation on the deduction of business interest. T.D. 9905 (Sept. 14, 2020), 2020-40 I.R.B. 614. The regulations follow the broad structure of the proposed regulations as described in the text and are substantively similar to those regulations in many respects. For example, the final regulations retain the provision that makes it clear that the business interest limitation rules have no effect on a corporation's earnings and profits. Reg. § 1.163(j)-4(c)(1). The final regulations take up approximately 160 pages of the Federal Register, so additional details about these regulatory changes are beyond the scope of a "fundamentals" book.

B. DEBT VS. EQUITY

3. SECTION 385

Page 147:

Section 385 Regulatory Developments. In October 2019, the Service issued final regulations removing the strict documentation regulations while noting that it might propose a modified version that is simpler and more streamlined. T.D. 9880 (Oct. 31, 2019), 2019-47 I.R.B. 1085. Simultaneously, the Service issued an advance notice of proposed rulemaking indicating its intent to propose regulations that streamline and better target the distribution regulations, which treat as stock certain related-party debt issued in connection with distributions. REG-123112-19 (Oct. 31, 2019), 2019-47 I.R.B. 1104.

The saga continued in May 2020, when the Service finalized regulations under Section 385 in a form that was substantively the same as the temporary and proposed regulations issued in October 2016. T.D. 9897 (May 14, 2020), 2020-23 I.R.B. 882. Demonstrating once again that nothing involving Section 385 is ever “final,” the Service indicated that it would continue to consider modifications to streamline and better target the distribution regulations.

CHAPTER 4. NONLIQUIDATING DISTRIBUTIONS

A. INTRODUCTION

1. DIVIDENDS: IN GENERAL

Page 153:

In the Regulations assignment, replace § 1.301-1(c) with § 1.301-1(d).

B. EARNINGS AND PROFITS

Page 162:

Footnote 41. The citation to I.R.C. § 312(k)(3)(B) should be changed to I.R.C. § 312(k)(3)(B)(i).

Page 163:

In the list of income and expense items in the Problem, it should be assumed that the depreciable property purchased by X has a 7-year class life. For computational convenience, also assume that the property was fully expensed under Section 168(k) despite the phase-out of 100% expensing that began in 2023 and continues through 2028.

C. DISTRIBUTIONS OF CASH

Page 163:

In the Regulations assignment, replace § 1.301-1(a), (b) with § 1.301-1(a), (c)

Page 164:

The rule in the regulations regarding proration of current earnings and profits among distributions to determine dividend status previously only applied when both (1) the distributions during the taxable year consist only of money, and (2) those distributions exceed the current earnings and profits for the year. The regulations have been amended to eliminate the first of those requirements. See Reg. § 1.316-2(b). So now proration of current earnings and profits will result when distributions during the year exceed current earnings and profits, regardless of the nature of the property distributed. The change was made to clarify the allocation of current earnings and profits in situations where a corporation distributes both money and other property. T.D. 9914, 85 F.R. 66476 (Oct. 20, 2020).

D. DISTRIBUTIONS OF PROPERTY

1. CONSEQUENCES TO THE DISTRIBUTING CORPORATION

d. DISTRIBUTIONS OF A CORPORATION'S OWN OBLIGATIONS

Page 172:

In the Regulations assignment, replace § 1.301-1(d)(1)(ii) with § 1.301-1(b).

Change the citations in footnote 73 to Reg. § 1.301-1(b), -1(g).

E. CONSTRUCTIVE DISTRIBUTIONS

Page 173:

In the Regulations assignment, replace § 1.301-1(j) with § 1.301-1(h).

CHAPTER 5. REDEMPTIONS AND PARTIAL LIQUIDATIONS

A. INTRODUCTION

Page 204:

At the end of the carryover paragraph, add: If the distributing corporation is publicly traded, it might also be subject to a one percent excise tax on the fair market value of any of its stock it repurchases. I.R.C. § 4501. See Chapter 5E4, *infra*.

At the end of the second full paragraph, add: The introduction of Section 4501, which imposes a one percent excise tax on repurchases of stock made by publicly traded corporations, slightly alters the stakes for public companies by creating a small disincentive to making redemptions that are treated as exchanges.

E. CONSEQUENCES TO THE DISTRIBUTING CORPORATION

Page 253:

4. THE EXCISE TAX ON CORPORATE STOCK BUYBACKS

Code: § 4501.

In the Inflation Reduction Act of 2022, Congress added Section 4501, which imposes an excise tax on any “covered” corporation in an amount equal to one percent of the fair market value of the corporation’s stock that the corporation repurchases after December 31, 2022. I.R.C. § 4501(a). A corporation is a “covered” corporation if it is a U.S. corporation whose stock is traded on an established securities market. I.R.C. § 4501(b). The covered corporation is also subject to the excise tax to the extent that the covered corporation’s stock is purchased by a partnership or corporation that is more than 50 percent owned by the covered corporation. I.R.C. § 4501(c)(2). The excise tax is imposed on the covered corporation itself, not on the shareholders from whom the stock is repurchased. The amount subject to the tax is the fair market value of the repurchased stock, not the gain from the repurchase (i.e., there is no reduction for shareholders’ stock basis).

Section 4501 contains a “netting” rule that provides that the amount subject to the excise tax is reduced by the fair market value of any stock issued by the covered corporation during the taxable year. I.R.C. § 4501(c)(3). Thus, the excise tax only applies to the extent that the value of the corporation’s stock repurchased during the taxable year exceeds the value of the corporation’s stock issued during the taxable year.

Several exceptions further narrow Section 4501’s application. The stock buyback tax does not apply (1) to the extent the stock repurchase is treated as a dividend (I.R.C. § 4501(e)(6)), (2) when it is a de minimis repurchase because the total value of the stock repurchased in the taxable year does not exceed \$1,000,000 (I.R.C. § 4501(e)(3)), (3) if it is a repurchase of stock by a regulated investment company (i.e., a mutual fund) or real estate investment trust (I.R.C. § 4501(e)(5)), (4) when the stock repurchased (or an amount of stock equal to the value of the stock repurchased) is contributed to certain employee retirement funds (I.R.C. § 4501(e)(2)), (5) to the extent the repurchase is tax-free to the shareholder because it is part of a qualified reorganization plan under Section 368 (I.R.C. § 4501(e)(1)), or (6) under regulations issued by the IRS, repurchases by securities dealers in the ordinary course of business (I.R.C. § 4501(e)(4)).

The corporation may not take a deduction for the payment of any tax imposed by Section 4501. I.R.C. § 275(a)(6).

CHAPTER 6. STOCK DIVIDENDS AND SECTION 306 STOCK

B. TAXATION OF STOCK DIVIDENDS UNDER SECTION 305

Page 309:

Replace footnote 16 with: Reg. §§ 1.301-1(b); 1.305-1(b)(1). In the case of a noncorporate shareholder, taxable stock dividends may be qualified and eligible for preferential rates under Section 11(h).

Change the citation in footnote 17 to: Reg. § 1.301-1(g).

CHAPTER 11. NONACQUISITIVE, NONDIVISIVE REORGANIZATIONS

A. TYPE E: RECAPITALIZATIONS

1. INTRODUCTION

Page 523:

In the Regulations assignment, replace § 1.301-1(*l*) with § 1.301-1(j).

2. TYPES OF RECAPITALIZATIONS

d. STOCK EXCHANGED FOR BONDS

Page 534:

In footnote 24, Prop. Reg. § 1.301-1(j) has been finalized and replaced Reg. § 1.301-1(*l*).

CHAPTER 12. CARRYOVERS OF CORPORATE TAX ATTRIBUTES

C. LIMITATIONS ON NET OPERATING LOSS CARRYFORWARDS: SECTION 382

3. RESULTS OF AN OWNERSHIP CHANGE

Page 585:

In September 2019, the Service proposed regulations that are intended to provide guidance about the method for determining a corporation's net unrealized built-in loss, net unrealized built-in gain, realized built-in gain, and realized built-in loss. REG-125710-18 (Sept. 10, 2019), 2019-40 I.R.B. 785. A discussion of the details of the proposed regulations is more complex than is merited in a "fundamentals" book.

PART THREE: TAXATION OF S CORPORATIONS

CHAPTER 15. S CORPORATIONS

D. TREATMENT OF THE SHAREHOLDERS

3. LOSS LIMITATIONS

a. IN GENERAL

Page 696:

The Coronavirus Aid, Relief, and Economic Security (“CARES”) Act delayed application of the Section 461(*l*) limitation on excess business losses of noncorporate taxpayers until years after 2020. The American Rescue Plan Act of 2021 extended the provision through 2026, and the Inflation Reduction Act of 2022 further extended it through 2028. The Biden administration continues to propose making Section 461(*l*) permanent.

For 2023, the indexed thresholds in Section 461(*l*)(3) are \$289,000 for single taxpayers and \$578,000 for a married couple filing a joint return.