

TAX REFORM PAC

712 H ST NE, #1239
WASHINGTON D.C. 20002-3627
TELEPHONE: (202) 864-1065
TAX@TAXREFORMPAC.ORG

Proposed Legislation:

S-Corporation “Small Business” Tax Reform for Charitable Remainder Trusts

Revised July 18, 2017

TAX REFORM PAC

712 H ST NE, #1239
WASHINGTON D.C. 20002-3627
TELEPHONE: (202) 864-1065
TAX@TAXREFORMPAC.ORG

CHARLES J. MCLUCAS, JR., CPA, PFS, AEP, CKA
RYAN M. BOURQUE, CPA, MB.T, CKA

S-Corporation “Small Business” Tax Reform for Charitable Remainder Trusts

“Small Business” S-Corporations need tax reform in the area of Charitable Trusts. Currently, the Tax Code doesn’t allow S-Corporations to contribute stock to a Charitable Remainder Trusts (“CRTs”) without triggered Unrelated Business Income Tax (“UBIT”).

1. Many of the S-Corporation shareholders in the United States are over 65 years old and are looking for tax efficient ways to sell their businesses, ensure the continuity of the companies they have built, provide for a secure retirement, and leave a legacy for their communities and country.
2. CRTs provide taxpayers who sell their businesses or appreciated assets with a steady stream of income for retirement, while providing for substantial contributions to charities and non-profits. This also creates an actuarially calculated current income tax deduction for the donor.
3. Shareholders of the 5.8 million S-Corporations in the United States are not permitted to sell or donate their shares to Charitable Remainder Trusts (“CRT’s”) because of current Unrelated Business Income Tax (“UBIT”) Rules. While it is acceptable to tax the income from ownership of this stock, it is unfair to impose tax on the sale of such stock.
4. Currently, the receipt and subsequent sale of S-Corporation Stock by a Charitable Remainder Trust (“CRT”) triggers a 100% tax due to the Unrelated Business Income Tax (“UBIT”) Rules.
5. The wording to change the Tax Code to eliminate the “UBIT” 100% tax on CRT’s who sell S-Corporation stock is simple and easy to implement, with a lack of impact elsewhere in the Internal Revenue Code.
6. The many charitable organizations in the country could receive substantial contributions. A further step for the PAC is to quantify the exact impact of this change with some Congressional Budget Office (“CBO”) scoring.
7. Using CRTs, The United States Treasury would receive substantial tax dollars over the life of the trust period. In some modeled cases, the Treasury would receive more revenue with this tax law change.
8. The financial services community (Attorney’s, CPA’s, Investment Advisors, Business Brokers and M&A firms, Professional Associations, etc.) would receive significant revenue from the potential sale and transition of S-Corporation “Small Businesses”. The taxes on these fees would be a revenue enhancement for treasury.

This “Small Business” S-Corporation Tax Reform for Charitable Remainder Trusts promote the building of the infrastructure in your community by the hard work and dedication from local charities and non-profits.

Very Truly Yours,

Chuck McLucas, CPA, PFS, AEP, CKA
Charles J. McLucas, Jr., CPA, CKA (PAC Director)

Ryan M. Bourque, CPA, MB.T, CKA
Ryan M. Bourque, CPA, MB.T, CKA (PAC Director)

TAX REFORM PAC

712 H ST NE, #1239
WASHINGTON D.C. 20002-3627
TELEPHONE: (202) 864-1065
TAX@TAXREFORMPAC.ORG

SPECIFIC TAX CODE CHANGES NEEDED:

Two statutes would have to be changed:

#1 - The list of eligible shareholders would have to be expanded to include a Charitable Remainder Trust “CRT”

#2 - The UBIT statute would have to be changed.

#1 - Amend § 1361(c)(2)(A) to add:

(vii) A charitable remainder trust described in Section 664.

#2 - Amend § 512(e) to state:

26 U.S. Code § 512 - Unrelated business taxable income

(e) Special rules applicable to S corporations

(1) In general. If an organization described in section 1361(c)(2)(A)(vi), 1361(c)(6) **or 1361(c)(2)(vii)** holds stock in an S corporation, **the rules described in Section 512(c) pertaining to partnerships shall apply to the income of the S corporation.**

BACKGROUND:

Right now, 100% of the income of an S Corp (including long-term capital gains, interest, and dividends) are subject to the unrelated business income tax (“UBIT”). This is not the point of contention. The issue, however, is that the gain from selling the S corp stock is subject to the Unrelated Business Income Tax (“UBIT”). **Since the UBIT of a CRT is subject to a 100% income tax rate, nobody would want to put S corp stock into a CRT.**

The solution is to have the income from an S-Corporation be taxed the same way as a partnership; the same way as an LLC. No better; no worse. Fair and Equitable. Only the income from business operations would be hit with UBIT (income reported on Line-1 of Schedule K-1). There is generally no tax on investment income of a partnership, **nor the gain from selling the partnership interest.**

These changes would equalize the treatment of the sale of these business interests for all pass-through entities.

TAX REFORM PAC

712 H ST NE, #1239
WASHINGTON D.C. 20002-3627
TELEPHONE: (202) 864-1065
TAX@TAXREFORMPAC.ORG

FULL TEXT OF STATUTES, WITH SUGGESTED TEXT ADDED:

26 U.S. Code § 1361 - S corporation defined

(c) Special rules for applying subsection (b)

(2) Certain trusts permitted as shareholders

(A) In general. For purposes of subsection (b)(1)(B), the following trusts may be shareholders:

(i) A trust all of which is treated (under subpart E of part I of subchapter J of this chapter) as owned by an individual who is a citizen or resident of the United States.

(ii) A trust which was described in clause (i) immediately before the death of the deemed owner and which continues in existence after such death, but only for the 2-year period beginning on the day of the deemed owner's death.

(iii) A trust with respect to stock transferred to it pursuant to the terms of a will, but only for the 2-year period beginning on the day on which such stock is transferred to it.

(iv) A trust created primarily to exercise the voting power of stock transferred to it.

(v) An electing small business trust.

(vi) In the case of a corporation which is a bank (as defined in section 581) or a depository institution holding company (as defined in section 3(w)(1) of the Federal Deposit Insurance Act (12 U.S.C. 1813(w)(1))), a trust which constitutes an individual retirement account under section 408(a), including one designated as a Roth IRA under section 408A, but only to the extent of the stock held by such trust in such bank or company as of the date of the enactment of this clause.

(vii) A charitable remainder trust described in Section 664.

This subparagraph shall not apply to any foreign trust.

TAX REFORM PAC

712 H ST NE, #1239
WASHINGTON D.C. 20002-3627
TELEPHONE: (202) 864-1065
TAX@TAXREFORMPAC.ORG

DETAILED CHANGES TO UBIT LAW:

26 U.S. Code § 512 - Unrelated business taxable income

(e) Special rules applicable to S corporations

(1) In general. If an organization described in section 1361(c)(2)(A)(vi), 1361(c)(6) or 1361(c)(2)(vii) holds stock in an S corporation, **the rules described in Section 512(e) pertaining to partnerships shall apply to the income of the S corporation.**

(2) Basis reduction

Except as provided in regulations, for purposes of paragraph (1), the basis of any stock acquired by purchase (as defined in section 1361(e)(1)(C)) shall be reduced by the amount of any dividends received by the organization with respect to the stock.

(3) Exception for ESOPs

This subsection shall not apply to employer securities (within the meaning of section 409(l)) held by an employee stock ownership plan described in section 4975(e)(7).

TAX REFORM PAC

712 H ST NE, #1239
WASHINGTON D.C. 20002-3627
TELEPHONE: (202) 864-1065
TAX@TAXREFORMPAC.ORG

CURRENT LAW:

26 U.S. Code § 512 - Unrelated business taxable income

(e) Special rules applicable to S corporations

(1) In general. If an organization described in section 1361(c)(2)(A)(vi) or 1361(c)(6) holds stock in an S corporation—

(A) such interest shall be treated as an interest in an unrelated trade or business, and

(B) notwithstanding any other provision of this part—

(i) all items of income, loss, or deduction taken into account under section 1366(a), and

(ii) any gain or loss on the disposition of the stock in the S corporation,

shall be taken into account in computing the unrelated business taxable income of such organization.

(2) Basis reduction

Except as provided in regulations, for purposes of paragraph (1), the basis of any stock acquired by purchase (as defined in section 1361(e)(1)(C)) shall be reduced by the amount of any dividends received by the organization with respect to the stock.

(3) Exception for ESOPs

This subsection shall not apply to employer securities (within the meaning of section 409(l)) held by an employee stock ownership plan described in section 4975(e)(7).