

**CALIFORNIA LAWYERS ASSOCIATION TAXATION SECTION
WASHINGTON D.C. DELEGATION
2019 PROPOSAL**

**REQUEST FOR GUIDANCE REGARDING MAKING PROPER
S CORPORATION CONSENTS ON FORM 2553,
ELECTION BY A SMALL BUSINESS CORPORATION**

*(Clarifying Who and How to Sign the Form 2553 “Consent Statement” for
Grantor Trust Shareholders and Community Interest Spouse Shareholders)*

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¹ The comments contained in this paper are the individual views of the authors who prepared them, and do not represent the position of the California Lawyers Association.

² Although the authors and/or presenters of this paper might have clients affected by the rules applicable to the subject matter of this paper and have advised such clients on applicable law, no such participant has been specifically engaged by a client to participate on this project.

EXECUTIVE SUMMARY

Corporations which qualify as “**Small Business Corporations**” pursuant to Internal Revenue Code (“**IRC**”)³ Section 1361(b) may elect to be treated as an “**S Corporation**” if certain requirements are met. The election to be treated as an S Corporation (the “**S Election**”) is made on Form 2553, *Election by a Small Business Corporation* (“**Form 2553**”).⁴

One such requirement for a valid S Election is that “all shareholders in such corporation” must consent to the S Election.⁵ This consent is generally completed in Part 1, Sections J through N, inclusive, of the Form 2553 (the “**Consent Statement**”). The authors believe that additional guidance is needed to enable taxpayers to consistently and accurately complete the Consent Statement in a manner that will be accepted and further respected by the IRS and, sometimes more importantly, relied upon by others who, for instance, as a buyer, are relying upon the valid S Corporation status when acquiring stock of such intended target “S Corporation.”⁶

The negative consequences of an ineffective or invalid S Election can be severe. The issue regarding the validity of the original S Election due to a poorly or incorrectly prepared Form 2553 is generally not discovered for years, or even after decades have passed. One such negative consequence is that a corporation with an ineffective S Election is, in fact, taxed (or should have been taxed) as a C corporation (with all of the associated C corporation tax liabilities from previous open tax years still outstanding). All of the shareholders of such corporation would have received K-1’s used to prepare their individual income tax returns, which individual income tax returns will also be incorrect if the S Election was invalid.

Grantor Trust Shareholders. When S Corporation stock is owned by a trust that is treated as owned by an individual who is a citizen or resident of the United States under subpart E of part I of subchapter J of chapter 1 of the IRC (a “**Grantor Trust**”), the Form 2553 does not provide entirely clear instructions (the “**Instructions**”) as to: (1) which party should be identified or listed as the

³ All section references are to the Internal Revenue Code of 1986, as amended, and the Treasury Regulations promulgated thereunder unless otherwise noted.

⁴ Treas. Reg. Section 1.1362-6(a)(2)(i).

⁵ IRC Section 1362(a)(2).

⁶ After a Form 2553 is filed with the IRS by an S Corporation, the IRS will send a confirmation of such filing, generally by way of a CP261 or Ltr. 385C which states, in part, “*We’ve accepted your S Election.*” This is a bit confusing and somewhat misleading because the Form 2553 that is filed and for which a confirmation letter is received may actually be invalid (e.g., if a spouse with a community property interest or any other shareholder does not sign a Consent Statement).

“shareholder;” and (2) how the remainder of the Consent Statement should be completed (in a variety of scenarios). While the Instructions state that the shareholder “required to consent” should be listed in Column J, and Treas. Reg. Section 1.1362-6(b)(2)(iv) states that only the person treated as the shareholder of the S Corporation must consent (*i.e.*, generally an individual as the deemed owner, not the Grantor Trust as the shareholder of record) the Form 2553, Part I, Election Information, instructs that the “*shareholder*” be identified in Column J and provides a reference to “(*see instructions*).” In the authors’ experience, many of those completing the Form 2553 do not understand, for whatever reason, that the term “*shareholder*” for the purpose of entering the shareholder name in Column J is not always the actual shareholder of record (*e.g.*, when a Grantor Trust is the shareholder of record, the person or persons treated as the owner should be entered).

For the purpose of assisting those preparing complete and accurate Forms 2553, the authors propose: (1) updating Column J of Form 2553 to list “deemed shareholder” as a possible party written in Column J; (2) a “check box” on each shareholder line in Column J of the Consent Statement to help prompt or remind individual shareholders or deemed owners to list their individual name even if the shareholder of record is his or her Grantor Trust; and (3) additional detail and an example in the Instructions demonstrating a best practice for how the deemed owner of a Grantor Trust should consider completing the Consent Statement.

Spouse Owning a Community Property Interest. In the case of a spouse that owns solely a community property interest in S Corporation stock, in the authors’ experience, many taxpayers, again for whatever reason, are not aware that such community property spouses must also consent to the S Election, even though the Treasury Regulations and Instructions make it very clear. Similar to the above situations for Grantor Trusts, the authors propose: (1) updating Column J of Form 2553 to list “deemed shareholder” as a possible party written in Column J; (2) a “check-box” on the Form 2553, Part I, Election Information, in Column J on each shareholder line of the Consent Statement to prompt shareholders to identify spouses with solely a community property interest; (3) additional detail in Column L of the Instructions to provide that spouses with a community property interest should enter -0- shares owned; and (4) additional detail and an example in the Instructions demonstrating a best practice for how a spouse with solely a community property interest in shares should consider completing the Consent Statement.

At the end of this proposal, we provide a “redline” of our proposed changes to the Form 2553 and its Instructions. See Proposal, III.D, Final Proposed Changes, page 14.

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DISCUSSION

I. BACKGROUND

A. Small Business Corporations - Overview.

1. *In General.* IRC Section 1362(a) permits Small Business Corporations to affirmatively elect to be treated as S Corporations. A Small Business Corporation is a domestic corporation which is not an “ineligible corporation” and does not: (A) have more than 100 shareholders; (B) have as a shareholder a person (other than an estate, a trust described in Section 1361(c)(2), or an organization described in Section 1361(c)(6)) who is not an individual; (C) have a nonresident alien as a shareholder; or (D) have more than one class of stock.” (Emphasis added.)⁷

2. *A Trust as a Shareholder.*

A Small Business Corporation shareholder must be: (1) an individual; (2) an estate; (3) one of certain trusts permitted by IRC Section 1361(c)(2); or (4) an organization described by IRC Section 1361(c)(6)(*i.e.*, generally an IRC Section 501(c)(3) entity).

The following trusts are certain of the trusts that are permitted as shareholders of a Small Business Corporation:

a. Grantor Trusts. A trust which is treated (under subpart E of part I of subchapter J of chapter 1 of the IRC) as owned by an individual who is a citizen or resident of the United States (*i.e.*, a Grantor Trust).⁸ In the case of such a trust, the “deemed owner” shall be treated as the shareholder (*emphasis added*).⁹

b. Trusts Held at Death. A trust which was a Grantor Trust immediately before the death of its deemed owner, but only for the 2-year period beginning on the day of the deemed owner’s death.¹⁰ In the case of such a trust, the estate of the deemed owner “shall be treated as the shareholder.”¹¹

⁷ IRC Section 1361(b)(1).

⁸ IRC Section 1361(c)(2)(A)(i).

⁹ IRC Section 1361(c)(2)(B)(i).

¹⁰ IRC Section 1361(c)(2)(A)(ii).

¹¹ IRC Section 1361(c)(2)(B)(ii).

c. Testamentary Trusts. 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.¹² In the case of such a trust, the estate of the “deemed owner” shall be treated as the shareholder.¹³

d. Voting Trusts. A trust created primarily to exercise the voting power of stock transferred to it.¹⁴ In the case of such a trust, “each beneficiary of the trust shall be treated as a shareholder.”¹⁵

e. ESBT. An electing small business trust (“**ESBT**”).¹⁶ In the case of an ESBT, “each potential current beneficiary ... shall be treated as a shareholder.”¹⁷ If there is no current potential beneficiary for a period, the trust shall be treated as the shareholder during such period.¹⁸

f. QSST. A trust which qualifies as a qualified subchapter S trust (“**QSST**”).¹⁹ A QSST generally requires that, during the life of the current income beneficiary, there be only one (1) income beneficiary of the trust, and that all of the income of the trust be distributed to the beneficiary at least annually.²⁰

B. Consent Statements - Background.

An S Election is only valid if all shareholders of a Small Business Corporation on the date the S Election is made consent to such S Election.²¹ The S Election is not valid without a valid Consent Statement from each of the shareholders.²² The Consent Statement must be in the form of a written statement and must set forth, “[1] the name, address, and taxpayer identification number of the shareholder, [2] the number of shares of stock owned by the shareholder, [3] the date (or dates) on which the stock was acquired, [4] the date on which the shareholder’s taxable year ends, [5] the name of the S Corporation, [6] the corporation’s tax identification

¹² IRC Section 1361(c)(2)(A)(iii).

¹³ IRC Section 1361(c)(2)(B)(iii).

¹⁴ IRC Section 1361(c)(2)(A)(iv).

¹⁵ IRC Section 1361(c)(2)(B)(iv).

¹⁶ IRC Section 1361(c)(2)(A)(v).

¹⁷ IRC Section 1361(c)(2)(B)(v).

¹⁸ *Id.*

¹⁹ IRC Section 1361(d)(1).

²⁰ IRC Section 1361(d)(3).

²¹ IRC Section 1362(a)(2).

²² Treas. Reg. Section 1.1362-6(b)(1).

number, and [7] the election to which the shareholder consents.” (*Numbering and emphasis added.*)²³

Each Consent Statement must also be signed by the shareholder under penalties of perjury.²⁴

1. *Consent Statement – Trusts Eligible to Own S Corporation Stock.*

When stock in a Small Business Corporation is owned by a trust described in IRC Section 1361(c)(2)(A)(i) (*i.e.*, a Grantor Trust), including a QSST but excepting an ESBT, “only the person treated as the shareholder of the S Corporation ... must consent to the election.”²⁵

2. *Consent Statement – Community Interest in S Corporation Stock.*

When stock in a Small Business Corporation is owned by a husband and wife as community property, or if the income from the stock is community property, or is owned by tenants in common, joint tenants, or tenants by the entirety, each person having a community interest must consent to the S Election.²⁶

C. Issues and Consequences with an Ineffective S Election.

1. *Certain of the Tax Consequences of an Ineffective S Election.*

If a Small Business Corporation filed a Form 2553 and intended to make an effective S Election, when in fact it has not (as a result of an incorrect or incomplete Consent Statement), the consequences can be far reaching.

First, the tax classification of the Small Business Corporation is not an S Corporation. If all of the shareholders of a Small Business Corporation have not properly consented to an S Election, such S Election is not effective. Instead, the corporation should be taxed as a C corporation for all periods during which the S Election was intended to be effective. This means that the corporation has been filing income tax returns incorrectly (*i.e.*, Form 1120S instead of Form 1120), the shareholders have likely been filing income tax returns incorrectly (*i.e.*, reporting their allocable gain or loss from the S Corporation on their Form 1040), and there

²³ *Id.*

²⁴ *Id.*

²⁵ Treas. Reg. Section 1.1362-6(b)(2)(iv).

²⁶ Treas. Reg. Section 1.1362-6(b)(2)(i).

are likely entity-level income tax liabilities (Form 1120) for previous tax years in which the statute of limitations is still open for assessment.

Second, if an S Election was not effective, it can completely change the business deal and corporate formalities of a potential sale (*e.g.*, assignment of assets, possible state sales tax exposure, etc.). For example, as for the business deal, the shareholders (as well as future buyers of such shareholder's stock) are unable to make a valid IRC Section 338(h)(10) election to treat for income tax purposes a sale of S Corporation stock as a sale of assets (a “**338(h)(10) Election**”), which requires that the target be an S Corporation. If the buying party is unsure if the Consent Statement to an S Election was complete or correct and, therefore, the buying party is unsure whether the S Election was valid, the buying party will often require that the transaction be structured as a purchase and sale of assets (and not stock), by way of a direct sale of assets by the target corporation (or by way of another method, including requiring that the corporation undergo an expensive restructuring to reduce the risk that the buyer could be acquiring the stock in a C corporation (and its associated tax liabilities)).²⁷

Lastly, making last minute changes (when the invalid or potentially invalid S Election is discovered during due diligence) can add weeks and tens of thousands of additional (and unnecessary) legal fees to a transaction. A buying party generally refuses to pay for the additional fees and taxes as a result of the restructuring. To make matters worse, after such restructuring, the selling parties are still left with the potential C corporation tax liabilities associated with the potentially improper S Election.

2. *Procedures for Relief from Improper S Election.*

The IRS has at least four (4) different procedures currently available for use in obtaining relief in certain scenarios.

First, Rev. Proc. 2013-30 provides the exclusive simplified relief for S Corporations that failed to file a Form 2553 and serves as a consolidation of most previous revenue procedures.²⁸ There is no time limit for a Small Business Corporation to use Rev. Proc. 2013-30 so long as all returns of the corporation have been filed as an S Corporation (and other requirements have been met, including that

²⁷ One such restructuring is known as F reorganization/LLC conversion transaction. See Rev. Rul. 2008-18; see also PLR 201115016.

²⁸ Rev. Proc. 2013-30 is available for S Corporation elections, ESBT elections, QSST elections, and QSub Elections.

the corporation fails to qualify as an S Corporation solely because the Form 2553 was not timely filed).²⁹ Relief pursuant to Rev. Proc. 2013-30 is not automatic.

Second, Rev. Proc. 2004-35 provides relief for S Corporations where the spouse of a shareholder with a community property interest failed to consent to the S Election. If the only error in a timely filed and otherwise valid Form 2553 is that a spouse with a community property interest failed to consent, Rev. Proc. 2004-35 provides automatic relief.³⁰

Third, Treas. Reg. 1.1362-6(b)(3)(iii) provides S Corporations a procedure for requesting an extension of time to file required consents to an S Election that were not originally included in the filed Form 2553. Relief is not automatic. This request must show to the satisfaction of the IRS district director or director of the IRS service center with which the corporation files its income tax return that: (1) there is reasonable cause for the failure to file the consent; (2) the request is made within a reasonable time under the circumstances; and (3) the interests of the Government will not be jeopardized by treating the election as valid.³¹ In the authors' experience, the IRS is not consistent in responding to requests for an extension of time to file consents pursuant to Treas. Reg. Section 1.1362-6(b)(3)(iii).

Lastly, in addition to the above S Election relief procedures, and generally as a final option, a taxpayer can also seek a private letter ruling (“PLR”). More specifically, if a taxpayer is unable for whatever reason to use one of the S Election relief procedures discussed above, which is often the case, IRC Section 1362(f) provides that the IRS may grant a waiver of an inadvertently invalid or terminated S Election. Although relatively expensive to prepare due to the volume of information needed to make sure a request for a PLR (*see* Rev. Proc. 2019-1) and with an IRS user fee required, a PLR provides an avenue for certainty for taxpayers whose Form 2553 has a defect.

²⁹ Rev. Proc. 2013-30, Section 5.04.

³⁰ Rev. Proc. 2004-35, Section 4. Although the relief is “automatic,” Rev. Proc. 2004-35, Section 4.03 states, “[t]he Service will notify the shareholder of the acceptance of the shareholder’s request to file the late shareholder consent or the denial of a request that fails to satisfy the requirements of this revenue procedure.” In the authors’ experience, the IRS rarely responds with any type of acceptance letter.

³¹ Treas. Reg. Section 1.1362-6(b)(3)(iii)(A).

II. COMPLETING THE CONSENT STATEMENT.

Generally, the Consent Statement is made on the form provided in the Form 2553, namely, Part I, Columns J through N of the S Election Form (*i.e.*, Form 2553). The current S Election Form, Part I, Columns J through N (Rev. December 2017), is as follows:

Part I Election Information (<i>continued</i>) Note: If you need more rows, use additional copies of page 2.					
J Name and address of each shareholder or former shareholder required to consent to the election. (see instructions)	K Shareholder's Consent Statement Under penalties of perjury, I declare that I consent to the election of the above-named corporation (entity) to be an S corporation under section 1362(a) and that I have examined this consent statement, including accompanying documents, and, to the best of my knowledge and belief, the election contains all the relevant facts relating to the election, and such facts are true, correct, and complete. I understand my consent is binding and may not be withdrawn after the corporation (entity) has made a valid election. If seeking relief for a late filed election, I also declare under penalties of perjury that I have reported my income on all affected returns consistent with the S corporation election for the year for which the election should have been filed (see beginning date entered on line E) and for all subsequent years.		L Stock owned or percentage of ownership (see instructions)		M Social security number or employer identification number (see instructions)
	Signature	Date	Number of shares or percentage of ownership	Date(s) acquired	
				N Shareholder's tax year ends (month and day)	

As noted below (with emphasis added), the current Instructions to Form 2553 (Rev. December 2017) provide additional instruction on completing Column J, “*Name and address of each shareholder or former shareholder required to consent to the election;*” Column K, “*Shareholder's Consent Statement;*” and Column L, “*Stock owned or percentage of ownership.*”

Column J

Enter the name and address of each shareholder or former shareholder required to consent to the election. If stock of the corporation is held by a nominee, guardian, custodian, or an agent, enter the name and address of the person for whom the stock is held. If a single member limited liability company (LLC) owns stock in the corporation, and the LLC is treated as a disregarded entity for federal income tax purposes, enter the owner's name and address. The owner must be eligible to be an S Corporation shareholder.

For an election filed before the effective date entered for item E, only shareholders who own stock on the day the election is made need to consent to the election.

For an election filed on or after the effective date entered for item E, all shareholders or former shareholders who owned stock at any time during the period beginning on the effective date entered for item E and ending on the day the election is made must consent to the election.

If the corporation timely filed an election, but one or more shareholders didn't timely file a consent, see Regulations section 1.1362-6(b)(3)(iii). If the shareholder was a community property spouse who was a shareholder solely because of a state community property law, *see* Rev. Proc. 2004-35, 2004-23 I.R.B. 1029, available at IRS.gov/irb/2004-23_IRB#RP-2004-35.

Column K. Shareholder's Consent Statement

Each shareholder consents by signing and dating either in column K or on a separate consent statement. The following special rules apply in determining who must sign.

- If an individual and his or her spouse have a community interest in the stock or in the income from it, both must consent. For more information about community property, see Pub. 555.
- Each tenant in common, joint tenant, and tenant by the entirety must consent.
- A minor's consent is made by the minor, legal representative of the minor, or a natural or adoptive parent of the minor if no legal representative has been appointed.
- The consent of an estate is made by the executor or administrator.
- The consent of an electing small business trust (ESBT) is made by the trustee and, if a grantor trust, the deemed owner. See Regulations section 1.1362-6(b)(2)(iv) for details.
- If the stock is owned by a qualified subchapter S trust (QSST), the deemed owner of the trust must consent.

- If the stock is owned by a trust (other than an ESBT or QSST), the person treated as the shareholder by section 1361(c)(2)(B) must consent.

Continuation sheet or separate consent statement. If you need a continuation sheet or use a separate consent statement, attach it to Form 2553. It must contain the name, address, and EIN of the corporation and the information requested in columns J through N of Part I.

Column L

Enter the number of shares of stock each shareholder owns on the date the election is filed and the date(s) the stock was acquired. Enter -0- for any former shareholders listed in column J. An entity without stock, such as a limited liability company (LLC), should enter the percentage of ownership and the date(s) acquired.

A. Consent Statements for Grantor Trusts.

If stock in a Small Business Corporation is owned by a Grantor Trust, it is not entirely clear to many taxpayers, from the Form 2553 and from the Instructions, how the Consent Statement on the Form 2553 should be completed. The Form 2553, Column J, states “*Name and address of each shareholder or former shareholder required to consent to the election. (see instructions).*” The Instructions for Column J do not provide any specific instructions related to Grantor Trust shareholders (although Column J of the Instructions does provide very specific instructions when the shareholder is a single member LLC). It is unclear why Column J of the Instructions is so specific in instructing single member LLC shareholders, but silent regarding Grantor Trusts (and spouses with a community property interest). It appears that a Grantor Trust should default to the more general instruction to “*enter the name and address of each shareholder or former shareholder required to consent to the election.*” (In the case of a Grantor Trust shareholder, the authors believe that this Instruction is referring to the owner of the Grantor Trust.)

The Column K Instructions provide that, in the case of a Grantor Trust, the deemed owner must consent, and “[i]f the stock is owned by a trust (other than an ESBT or QSST), the person treated as the shareholder by Section 1361(c)(2)(B) must consent.” IRC 1361(c)(2)(B)(i) states that the deemed owner of a Grantor Trust “shall be treated as the shareholder.” Treas. Reg. Section 1.1362-6(b)(2)(iv) states

that, in the case of a Grantor Trust, “*only the person treated as the shareholder for purposes of section 1361(b)(1) must consent to the election.*” IRC Section 1361(b)(1) outlines the general requirements of a “small business corporation,” and acknowledges that trusts may be shareholders in certain contexts (including Grantor Trusts).

IRS rulings do seem clear and consistent that the Trustee of a Grantor Trust cannot consent to a valid S Election without the signatures of the deemed owners of the Grantor Trust. This point is made clear in PLR 201537001, where the Trustee of a Grantor Trust shareholder consented to the S Election but the deemed owners of the Grantor Trust (the grantors) did not. The S Election was determined to be ineffective.

Accordingly, while it is clear that the deemed owner(s) of a Grantor Trust must consent to an S Election, it is apparently unclear to many taxpayers from the Form 2553 wording if the actual shareholder of record (*i.e.*, the Grantor Trust) should be listed as a shareholder in Column J instead of or in addition to the deemed owners (*i.e.*, grantors). In the author’s opinion, it should only be the name of the deemed owner(s), with no mention of the Grantor Trust.

Furthermore, in the case of a joint Grantor Trust (*i.e.*, husband and wife settle a Grantor Trust together), it is also unclear who the “deemed owner” should be (*e.g.*, is the deemed owner the husband and wife jointly as to all shares, or half to husband and half to wife?). In the authors’ experience, these questions and uncertainties cause S Elections (and Consent Statements specifically) to be completed in a myriad of ways, and it is unclear what is: (1) acceptable (*i.e.*, effective); and (2) the best practice.

B. Consent Statements for Spouses with Solely a Community Property Interest.

If a shareholder’s spouse has solely a community property interest in the stock or in the income from it, both must sign a Consent Statement.³² In the authors’ experience, most shareholders are not aware of this requirement.

This requirement is confused by the Form 2553 and the Instructions. Again, the Form 2553, Column J, states “*Name and address of each shareholder or former shareholder required to consent to the election. (see instructions).*” The Instructions for Column J also do not provide any specific instructions related to spouses with a community property interest, with the exception of a reference to Rev. Proc. 2004-

³² Treas. Reg. Section 1.1362-6(b)(2)(i).

35 (procedures to file if a spouse with a community property interest failed to consent to the S Election). It is unclear why Column J of the Instructions is so specific in instructing single member LLC shareholders, but silent regarding spouses with a community property interest (and Grantor Trusts). It would be helpful if this was made more clear.

The authors understand that prior to the March 2005 revision of the Form 2553 (*i.e.*, in the December 2002 revision and prior), Column J of the Form 2553 prompted shareholders with a spouse that owns a community property interest to fill their name in Column J, as follows (with emphasis added):

J Name and address of each shareholder; <u>shareholder's spouse having a community property interest in the corporation's stock</u> ; and each tenant in common, joint tenant, and tenant by the entirety. (A husband and wife (and their estates) are counted as one shareholder in determining the number of shareholders without regard to the manner in which the stock is owned.)	K Shareholders' Consent Statement. Under penalties of perjury, we declare that we consent to the election of the above-named corporation to be an S corporation under section 1362(a) and that we have examined this consent statement, including accompanying schedules and statements, and to the best of our knowledge and belief, it is true, correct, and complete. We understand our consent is binding and may not be withdrawn after the corporation has made a valid election. (Shareholders sign and date below.)		L Stock owned		M Social security number or employer identification number (see instructions)	N Shareholder's tax year ends (month and day)
	Signature	Date	Number of shares	Dates acquired		

As outlined in the proposal below, the authors believe that more comprehensive language in Column J (as was the case prior to March 2005) and a check-box if the shareholder is a spouse with a community property interest, would greatly decrease the number of ineffective S Elections.

Column K of the Instructions does clarify that spouses with a community property interest must consent to the S Election. It does not, however, provide any guidance or examples of how the Consent Statement should be completed for spouses with a community property interest (*e.g.*, should they be listed as a "shareholder" in Column J? How much stock do they own?). The authors believe that an example of how a spouse with a community property interest should complete the Consent Statement would assist taxpayers and tax practitioners to correctly complete the Form 2553.

III. PROPOSAL.

A. The IRS Should Change the Form 2553 and Instructions to Better Instruct a Grantor Trust Shareholder.

The authors propose two (2) changes to the S Election Form, and one (1) change to the Instructions, to help taxpayers and practitioners correctly complete Consent Statements.³³

First, in the S Election Form, the authors recommend that Column J be updated to read as follows:

“Name and address of each shareholder, *deemed shareholder*, or former shareholder required to consent to the election. (see instructions)”

(Emphasis added to show proposed new language.)

Second, in the S Election Form, the authors recommend a small “checkbox” in each Column J space, which states “Grantor Trust Owner” next to it. By doing so, it will immediately alert a shareholder that owns the interest in a Grantor Trust that the owner of such Trust must be listed in Column J and sign the Consent Statement (assuming that is the intent of the S Election Form).³⁴

Third, in the Instructions, the authors also propose that at the end of Part I (*i.e.*, after Column N), an “Examples” section be added to demonstrate best practices for completing the Consent Statement when there is a Grantor Trust shareholder.³⁵ This would help taxpayers and practitioners file S Election Forms completely and consistently. The example for a Grantor Trust shareholder could provide clarity and instruction to all of the questions outlined above, as follows:

³³ We understand that from a government viewpoint, revising the S Election Form and the Instructions is easier than issuing a Revenue Ruling, Revenue Procedure, or Treasury Regulations. In Revenue Procedure 2012-29, the IRS provided sample language for the purpose of making 83(b) elections. This was well received in the tax community. In a perfect world, the IRS would issue a Revenue Procedure, similar to Revenue Procedure 2012-29, with examples of how to make a proper S Election in different scenarios, including for grantor trusts and community property spouses, among others.

³⁴ There should also probably be a box that states: “Other” in addition to the boxes for Community Property Spouse and Grantor Trust Owner so that someone filling out the S Election Form does not think they must check one of the boxes for Community Property Spouse or Grantor Trust Owner.

³⁵ In addition, a flow chart in the Instructions would be helpful in providing guidance in how to properly prepare the S Election Form.

EXAMPLE 2, GRANTOR TRUST. FACTS: The Doe Family Trust, a “grantor trust” under subpart E of part I of subchapter J of chapter 1 of the Internal Revenue Code that is qualified to hold shares in an S Corporation pursuant to IRC Section 1361(c)(2)(A)(i), for which Jane Doe and John Doe, a married couple, are the joint owners, is the sole record owner of 100% of the issued and outstanding shares in Corporation, which the Doe Family Trust acquired on 12/15/2018. Jane Doe and John Doe are completing and filing Form 2553 on 12/31/2018 for a future effective date. Jane Doe and John Doe, as the “deemed shareholders,” should complete Part I, Columns J-N, as follows:

<input type="checkbox"/> Community Property Spouse <input checked="" type="checkbox"/> Grantor Trust Owner Jane Doe 1234 Main Street Example, State 00000	<i>Jane Doe</i>	12/31/2018	50%	12/15/2018	xxx-xx-xxxx	12/31
<input type="checkbox"/> Community Property Spouse <input checked="" type="checkbox"/> Grantor Trust Owner John Doe 1234 Main Streetm Example, State 00000	<i>John Doe</i>	12/31/2018	50%	12/15/2018	xxxx-xx-xxxx	12/31

B. The IRS Should Change the S Election Form and Instructions to Better Instruct a Spouse with a Community Property Interest in S Corporation Shares.

The authors propose the same changes to the S Election Form and to the Instructions in the case of a spouse with a community property interest in shares.

First, in the Form 2553, the authors recommend that Column J be updated to read as follows:

“Name and address of each shareholder, *deemed shareholder*, or former shareholder required to consent to the election. (see instructions)”

(Emphasis added to show proposed new language.)

Second, in the S Election Form, the authors recommend a small “checkbox” in each Column J space, which states “Community Property Spouse” next to it. By doing so, it will immediately alert a shareholder that their spouse may also be required to be listed in Column J and sign the Consent Statement, and make it

abundantly clear to anyone reviewing the S Election Form why a person is signing the Consent Statement.

Third, in the Instructions, the authors propose the following language be included in Column L: “A spouse who owns shares solely as community property should enter -0-.”

Fourth, in the Instructions, the authors propose that at the end of Part I (*i.e.*, after Column N), an “Examples” section be added to demonstrate best practices for completing the Consent Statement when there is a spouse with a community property interest. This would help taxpayers and practitioners file S Election Forms completely and consistently. The Example for a spouse with a community property interest could be as follows (if it correctly summarizes the IRS’ interpretation of best practices):

EXAMPLE 1, COMMUNITY INTEREST SPOUSE. FACTS: Jane Doe is the sole record owner of 100% of the issued and outstanding shares in Corporation, which she acquired on 12/15/2018. Jane Doe is married to John Doe in a community property state (*i.e.*, John Doe has a community property interest in the shares). Jane Doe and John Doe are completing and filing Form 2553 on 12/31/2018. Jane Doe and John Doe should complete Part I, Columns J-N, as follows:

<input type="checkbox"/> Community Property Spouse <input type="checkbox"/> Grantor Trust Owner Jane Doe 1234 Main Street Example, State 00000	<i>Jane Doe</i>	12/31/2018	100%	12/15/2018	xxx-xx-xxxx	12/31
<input checked="" type="checkbox"/> Community Property Spouse <input type="checkbox"/> Grantor Trust Owner John Doe 1234 Main Streetm Example, State 00000	<i>John Doe</i>	12/31/2018	-0-	12/15/2018	xxxx-xx-xxxx	12/31

C. The Proposed Changes Would Assist With Practical Problems of Selling S Corporations.

As noted above, the authors encounter incorrectly prepared Consent Statements, among other things, during due diligence of the target in a stock or asset sale. More often than not, the issues arise when an owner (or group of owners) desires to sell their S Corporation (*i.e.*, not because of any action from the IRS). Buyers of such S Corporations are often not comfortable with the Consent Statements of the Company and require that the selling entities go through expensive

(and potentially unnecessary) corporate restructuring before finalizing a purchase, or worse, use such uncertainty as leverage to obtain more favorable deal terms. Sellers are then left with uncertainty regarding the tax status of such entities for previous tax years.

A number of issues are introduced to the sale of a business as a result of this restructuring, all of which harm the selling entity and its shareholders, including: (1) increased legal fees; (2) increased time before closing; (3) new deal terms (*i.e.*, the parties invariably contemplated the purchase of the stock of an S Corporation from the S Corporation’s shareholders, but now will be purchasing all of the equity interests in a wholly owned LLC from the S Corporation, with different tax consequences); and (4) continuing tax liability for the sellers, because the shareholders continue to own the S Corporation.³⁶ For example, one very common scenario is that a buyer will require that an S Corporation go through a restructuring prior to completing its acquisition of the S Corporation’s business, and will thereafter not agree to reimburse the seller for the increased taxes associated with selling the assets of the S Corporation (as opposed to the stock in the S Corporation).

This can all be avoided by correctly filed S Elections.

D. Final Proposed Changes (as reflected in Redline (underlined, bolded, and CAPITALIZED))

Part I Election Information (continued) Note: If you need more rows, use additional copies of page 2.					
<p style="text-align: center;">J</p> <p>Name and address of each Shareholder, DEEMED SHAREHOLDER, or former shareholder required to consent to the election. (see instructions INCLUDING FOR COLUMN K)</p>	<p style="text-align: center;">K</p> <p>Shareholder’s Consent Statement</p> <p>Under penalties of perjury, I declare that I consent to the election of the above-named corporation (entity) to be an S corporation under section 1362(a) and that I have examined this consent statement, including accompanying documents, and, to the best of my knowledge and belief, the election contains all the relevant facts relating to the election, and such facts are true, correct, and complete. I understand my consent is binding and may not be withdrawn after the corporation (entity) has made a valid election. If seeking relief for a late filed election, I also declare under penalties of perjury that I have reported my income on all affected returns consistent with the S corporation election for the year for which the election should have been filed (see beginning date entered on line E) and for all subsequent years.</p>		<p style="text-align: center;">L</p> <p>Stock owned or percentage of ownership (see instructions)</p>		<p style="text-align: center;">M</p> <p>Social security number or employer identification number (see instructions)</p>
	Signature	Date	<p>Number of shares or percentage of ownership</p>	<p>Date(s) acquired</p>	

³⁶ See Rev. Rul. 2008-18; PLR 201115016.

<input type="checkbox"/> <u>COMMUNITY PROPERTY SPOUSE</u> <input type="checkbox"/> <u>GRANTOR TRUST OWNER</u>						
<input type="checkbox"/> <u>COMMUNITY PROPERTY SPOUSE</u> <input type="checkbox"/> <u>GRANTOR TRUST OWNER</u>						

Column J

Enter the name and address of each shareholder or former shareholder required to consent to the election. If stock of the corporation is held by a nominee, guardian, custodian, or an agent, enter the name and address of the person for whom the stock is held. If a single member limited liability company (LLC) owns stock in the corporation, and the LLC is treated as a disregarded entity for federal income tax purposes, enter the owner's name and address, **NOT THE NAME OF THE LLC**. The owner must be eligible to be an S corporation shareholder. **THE SAME RULES APPLY TO DEEMED OWNERS OF GRANTOR TRUSTS WHO MUST BE LISTED, NOT THE NAME OF THE GRANTOR TRUST. THE NAME OF THE SPOUSE THAT OWNS SHARES SOLELY AS COMMUNITY PROPERTY MUST ALSO BE LISTED. (SEE INSTRUCTIONS AT COLUMN K FOR MORE INFORMATION REGARDING WHOSE NAME SHOULD BE LISTED.)**

For an election filed before the effective date entered for item E, only shareholders who own stock on the day the election is made need to consent to the election.

For an election filed on or after the effective date entered for item E, all shareholders or former shareholders who owned stock at any time during the period beginning on the effective date entered for item E and ending on the day the election is made must consent to the election.

If the corporation timely filed an election, but one or more shareholders didn't timely file a consent, see Regulations section

1.1362-6(b)(3)(iii). If the shareholder was a community property spouse who was a shareholder solely because of a state community property law, *see* Rev. Proc. 2004-35, 2004-23 I.R.B. 1029, available at IRS.gov/irb/2004-23_IRB#RP-2004-35.

Column K. Shareholder's Consent Statement

Each shareholder consents by signing and dating either in column K or on a separate consent statement. The following special rules apply in determining who must sign.

- If an individual and his or her spouse have a community interest in the stock or in the income from it, both must consent. For more information about community property, *see* Pub. 555.
- Each tenant in common, joint tenant, and tenant by the entirety must consent.
- A minor's consent is made by the minor, legal representative of the minor, or a natural or adoptive parent of the minor if no legal representative has been appointed.
- The consent of an estate is made by the executor or administrator.
- The consent of an electing small business trust (ESBT) is made by the trustee and, if a grantor trust, the deemed owner. *See* Regulations section 1.1362-6(b)(2)(iv) for details.
- If the stock is owned by a qualified subchapter S trust (QSST), the deemed owner of the trust must consent.
- If the stock is owned by a trust (other than an ESBT or QSST), the person treated as the shareholder by section 1361(c)(2)(B) must consent.

Continuation sheet or separate consent statement. If you need a continuation sheet or use a separate consent statement, attach it to Form 2553. It must contain the name, address, and EIN of the corporation and the information requested in columns J through N of Part I.

Column L

Enter the number of shares of stock each shareholder owns on the date the election is filed and the date(s) the stock was acquired. Enter -0- for any former shareholders listed in column J. An entity without stock, such as a limited liability company (LLC), should enter the percentage of ownership and date(s) acquired. **A SPOUSE WHO OWNS SHARES SOLELY AS COMMUNITY PROPERTY SHOULD ENTER -0-.**