



ABA Subchapter S News



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IRS Issues Final Rules on Reduction of Tax Attributes by S Corporations That Have COD Income

In final regulations (T.D. 9469) that are effective October 30, 2009, the IRS describes how an S corporation should reduce its tax attributes under section 108(b) for taxable years in which the S corporation has nontaxable income from discharged debt. The rules also address how an S corporation that has cancellation of debt (COD) income must allocate excess losses and deductions to its shareholders after section 108(b) tax attribute reductions and provide an example that clarifies how the allocation rules apply when a terminating election is made. While the final rules retain most of the provisions in the proposed rules that were issued in August 2008, the new rules adopt some changes.

In general, section 108(a) allows a taxpayer to exclude COD income from gross income if the cancellation occurs under certain circumstances, including while the taxpayer is bankrupt or insolvent. Section 108(b) requires such a taxpayer to reduce certain tax attributes, such as any net operating loss for the tax year of the discharge and any NOL carryover to that tax year.

Some of the changes adopted in the final rules include the elimination of the ordering approach for determining the character of the amount of the S corporation's excess deemed NOL that is allocated to a shareholder. Under the final rules, the S corporation's excess deemed NOL that is allocated to a shareholder should consist of a proportionate amount of each item of the shareholder's loss or deduction that is disallowed for the taxable year of the cancellation of debt under section 1366(d)(1). In addition, the final rules clarify that a deemed NOL does not include losses suspended under section 465 or section 469 and also that section 108(d)(7)(B) applies to any shareholder, including one that is an employee stock ownership plan, that has disallowed losses and deductions for the tax year of the discharge under section 1366(d)(1).

Furthermore, the rules modify the shareholder information reporting requirement in the proposed rules in order to reduce dependence on shareholders who provide incorrect information or fail to furnish information. According to the rules, in some situations the S corporation may rely on its own books and records as well as other available information to determine a shareholder's disallowed losses or deductions under section 1366(d)(1). However, the S corporation must know if the amount reported by the shareholder is inaccurate or the information, as provided, appears to be incomplete or incorrect. The rules do not include any provisions addressing consequences to shareholders who either fail to report this information to the S corporation or report incorrect information to the S corporation. However, the IRS noted that the application of some other section of the code which requires certain reporting by an S

corporation shareholder helps to ensure consistency between the S corporation's return and the shareholder's return. [Click here](#) to view the final rules.



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