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Making Subchapter S Work

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Making Subchapter S Work

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Subchapter S of the Internal Revenue Code continues
to illustrate the enormous gulf that too often exists be-
tween a good, simple idea and its statutory expression.
The provision was designed to permit the incorporation
of small businesses without subjecting their owners to
the burden of double taxation—or, more accurately, to
the need to engage in sophisticated tax planning to avoid
that tax. Subchapter S, however, has never fulfilled that
promise. The combination of highly restrictive definitional
limitations, exacting procedural requirements, and defec-
tive substantive provisions has caused the use of the
Subchapter S corporation to be far more complex and
expensive—and dangerous—than the use of either partner-
ships or regular corporations.

If the maximum rate of tax applicable to individual
taxpayers is reduced in accordance with the current
legislative proposals, the popularity of the recently re-
named S corporation should increase significantly. In-
deed, if the maximum individual rate is reduced relative
to the maximum corporate rate as proposed in the Sen-
ate,1 the use of S corporations undoubtedly will increase
dramatically. This expanded use of S corporations by
taxpayers whose tax advisors lack experience with Sub-
chapter S enhances the importance of rationalizing the
taxation of this form of investment vehicle.

A. An Unfinished Revision

After nearly a quarter of a century of struggling with
the consequences of the original version of Subchapter
S, in 1982 the Congress enacted the Subchapter S 
Revision Act.2 In an effort to eliminate the absurd inequi-
ties that permeated that first attempt to extend conduit
taxation to incorporated small businesses, the system for
taxing income derived by an S corporation, and distribu-
tions from such a corporation, was thoroughly revised.
While those provisions are far from perfected, the solu-
tions contained in the Revision Act greatly rationalized
the substantive provisions of Subchapter S.

Congress' clear intention was to make Sub-
chapter S 'user friendly.'

The definitional and procedural requirements of Sub-
chapter S, however, were little changed in 1982. Perhaps
because those features of Subchapter S had been re-
peatedly amended in prior years and their most egregious
faults eliminated,3 the 1982 revision addressed the sub-
stantive provisions almost exclusively. As a result, eligi-

1See Joint Committee on Taxation, Summary of the Tax Reform Provisions in H.R. 3838 as Ordered Reported by the Senate Committee on Finance, May 12, 1986, reprinted in Tax Notes, May 19, 1986, p. 699.
that such a trust can be a shareholder for 60 days but only if it receives the S corporation stock pursuant to a will. In that event, the trust is a real shareholder of the corporation for all purposes for that brief period. But what if the stock is retained beyond 60 days? If the retention proceeds from ignorance, at least, it may produce an inadvertent termination in which event the trust may still be recognized as a shareholder for a period of several months, or perhaps more. Or, what if the trust acquired its stock in some other manner? Again, inadvertent termination relief may be available. For income reporting purposes, during this undefined period the trust will be treated as a true shareholder. For other purposes, such as consenting to a revocation of the election, its status is unresolved.

The dichotomy between the 'real' law of Subchapter S and the law as it appears from the Code is substantial and increasing.

Even if the transfer to the trust is quite deliberate, the trust may nonetheless still be treated as a permissible shareholder—for at least some purposes. Thus, for perhaps one or two months, such a transitory trust might be "ignored." Whether such an ignored trust must report income or can consent to elections is wholly unresolved. It does appear, however, that an ignored trust may own stock on the day the election is filed without destroying the validity of the election.

However, if this deliberate trust owned stock on the day the election was filed and the holding persisted for more than a transitory period, it will not be recognized as a shareholder and the S election will not be effective—unless, of course, the trust meets the requirements for a qualified Subchapter S trust. In that event, the faulty election will be treated as a termination and the trust can be recognized as a shareholder.

These improprieties under Subchapter S are not attributable to the Service's having ruled inappropriately but rather to the inherently inconsistent definitional and procedural provisions that Congress inserted into Subchapter S. The reasoning of these private rulings is dubious but the results obtained are entirely consistent with sound tax policy. Congress left the Internal Revenue Service with the task of reconciling a generally restrictive statutory framework with the liberalizing amendments added in 1982. It is hardly unreasonable for the Service to conclude that it could not grant relief to accidental terminations of elections but deny relief to faulty elections that involved indistinguishable errors.

The Service cannot succeed in satisfactorily reconciling these contradictory themes and the effort to do so will inevitably be counterproductive to the overall objective of minimizing the complexity and obscurity of Subchapter S. The consequences of this liberalizing series of private rulings has been to leave the state of the law in a far different posture from what might be supposed from a reading of the highly restrictive provisions of the Code. At the moment, the very existence of these liberalizing rules is known only to the relatively few practitioners that follow the private rulings. Even when regulations are issued, they are unlikely to embody all of the remedial policies reflected in the current rulings. As suggested above, the precise scope of the transitory shareholder rule is likely to remain unclear for decades.

Even if the rules and procedures under Subchapter S are ultimately established, those rules will necessarily be internally inconsistent in both spirit and result. Since some statutory provisions cannot be modified, inflexible and restrictive rules will co-exist with the broadly remedial. As a result, it will be difficult for practitioners to obtain a "feel" for the provisions of Subchapter S. Moreover, the substantive result of these rules will appear, and often may be, unfair as instances of sweeping relief contrast with oppressive results reached in seemingly similar circumstances. And finally, the attempt to reconcile inconsistent rules cannot avoid producing complex and difficult to comprehend regulatory provisions. Thus, the incidence of taxpayer error will remain high notwithstanding the Service's attempt to proceed as flexibly as a broad construction of the Code permits.

For these reasons, it is not satisfactory to attempt to rationalize the definitional and procedural provisions of Subchapter S through the rulings and regulations process. As recent rulings illustrate, considerable effort will be required to reconcile these provisions. Undoubtedly, even greater effort will be required to produce rational and consistent regulations. That effort would be better spent in revising the Code provisions themselves by eliminating the oppressive remnants of the original legislation and consistently extending the philosophy of the 1982 amendments. What is required to permit Subchapter S to fulfill its promise is a comprehensive revision of the statutory provisions themselves.

The reasoning of these private rulings is dubious, but the results obtained are entirely consistent with sound tax policy.

2. The Effective Date of the Election: the Price of Stinginess. The flaw in the provisions of Subchapter S that govern the effective date of the election is best understood, oddly enough, by examining the provisions that control the effective date of the termination of Subchapter S elections. Under the rules in effect prior to 1982, the termination of a Subchapter S election could occur only as of the end of a taxable year. Moreover, if the termination were by a voluntary revocation, the termination could only be prospective. That limitation was unsatisfactory to many S corporation shareholders who discovered during a taxable year that changing circumstances had left their election unattractive.

Fortunately, a solution was at hand. If the election terminated involuntarily—because the corporation no longer met the definitional requirements for electing S status—the termination was retroactive to the beginning of the taxable year. The other side of strict definitional requirements was that it was terribly simple to fail the

\[\text{Former I.R.C. section 1372(e)(2).}\]
S corporations no longer have the ability to retroactively terminate their status.

That substantial improvement in the rationality of the procedures governing the termination of S elections was achieved at only a minimal increase in the complexity of the substantive provisions of Subchapter S. Permitting mid-year terminations required that the income for the year of termination be allocated between the short periods preceding and following the termination. Such an allocation, however, must also be made in any year in which stock in an S corporation is transferred to ensure that the transferor and transferee are appropriately taxed. Thus the need for an allocation in the year of termination did not inject a novel requirement into the taxation of S corporations. Moreover, the administrative burden of making income allocations was lessened by permitting the income for the termination year to be prorated over the entire year. The expense and inconvenience of an interim closing of the books thus could be avoided if the parties so desired.

Unfortunately, the rules governing the making of elections were not similarly rationalized. Rather, the requirement of the original Subchapter S that elections become effective only at the beginning of a taxable year was retained. While that limitation may appear harmless enough, although needlessly restrictive, in fact it contributes to a surprising degree to the excessively technical and slightly irrational nature of Subchapter S.

(a) Since the definitional requirements for electing Subchapter S status remain tightly defined and the procedural requirements highly technical, it continues to be far too easy to make an invalid election. And, because the election can be effective only as of the beginning of the taxable year, the cost of that failure can be excessively great: the loss of Subchapter S status for an entire year. As a result, a disproportionate importance attaches to compliance with a long series of highly technical requirements.22

Enormous stress is placed upon the definitions contained in these procedural rules.

Because taxpayers have only one opportunity in a year to elect Subchapter S status, enormous stress is placed upon the definitions contained in these procedural rules. Quite meaningless questions, such as the day on which a corporation is deemed to first have shareholders under state law,23 assume undue significance. Two quite conflicting consequences have resulted from the importance attached to these technical requirements. Most obviously, many taxpayers have been denied Subchapter S status for their corporations for an entire year, or more, because of highly technical defects in the election process. Those results, while perhaps unavoidable under the technical language of the statute, are nevertheless inconsistent with the more general congressional desire to eliminate needless "traps for the unwary" in the administration of Subchapter S.

On the other hand, because these technically invalid elections are clearly incompatible with sound tax policy, the Service has frequently sought to avoid those results through unusually liberal constructions of the statutory requirements. As described above, private rulings have been issued in which impermissible shareholders have been ignored because they were "transitory" and in which a QSST trust was treated as a permitted shareholder even though the beneficiary had failed to elect that status.

If the Congress had extended to the making of S elections the same flexibility that it extended to the
revoking of elections, the stress on the statutory definitions would have been avoided and the resulting distortion of the statutory language unnecessary. If, for example, the existence of a corporate shareholder on the first day of a taxable year only meant that the election would become effective on the following day, it plainly would be unnecessary to evolve rules permitting and defining transitory shareholders.

Such a rule might permit further simplifications. More flexible elections would make it unnecessary to permit retroactive elections during a grace period. The series of rules defining the grace period and the effect of an invalid retroactive election during the grace period could be eliminated.

(b) Subchapter S does not contain any concept of change of corporate ownership. Rather, the traditional concept of the separate entity of the corporation prevails. If all of the stock of a corporation is purchased in the middle of a year, the entirely new shareholder group is no more able to elect under Subchapter S prior to the end of the year than were the sellers. That result is plainly inappropriate.

There is no obvious reason why a corporation should be permitted to make a one-day election for the purpose of passing an extraordinary loss through to its shareholders.

The broader picture, however, is even worse for in this area, too, the Service has attempted to avoid harsh results through liberal rulings when some basis for that flexibility was presented. And, as before, that liberality has created a less than rational pattern of sometimes harsh, sometimes liberal rules. If the purchasing shareholders have the good fortune to purchase the stock of a corporation from a corporation that had been filing a consolidated return, the S election may be made immediately. It seems that under the consolidated return regulations, the short period commencing with the deconsolidation of a subsidiary is treated as a separate taxable year.24 For that highly technical reason, the Service has repeatedly ruled that such an acquired corporation may file an S election within the grace period that begins with the first day of that short year.25

Needless, perhaps, to observe, the ability to elect under Subchapter S should not turn on the fortuity of a stock purchase from a consolidated group. A more flexible election procedure would avoid that discontinuity.

(c) In one respect, the flexibility of the revocation rule is too liberal. There is no obvious reason why a corporation should be permitted to make a one-day election for the purpose of passing an extraordinary loss through to its shareholders. A more flexible election procedure would aggravate that possibility for it would become easier for a corporation to elect S treatment for the period of time in which it was accomplishing a full or partial liquidation of its assets.

Regardless of whether the election or the revocation occurs in mid-year, Subchapter S elections by previously nonelecting, or "C" corporations, for a period shorter than, say, one year should not be permitted. While that requirement could be imposed in a variety of ways, it would seem appropriate to simply bar Subchapter S treatment for any period to a corporation that had ever been a nonelecting corporation if any form of termination of S status occurs within a prescribed period of time following the election.

3. The Qualified Subchapter S Trust: The Futility of Stinginess. This third example of the tension between rigidity and flexibility in the procedural requirements of Subchapter S illustrates a somewhat different point. For better or worse, Subchapter S is a part of our Internal Revenue Code. The Congress cannot simultaneously make Subchapter S useful and insulate it from the carnival of tax planning that occurs everywhere else.

The most liberal provision in the definition of a small business corporation is the one permitting qualified Subchapter S trusts to be shareholders. But the definition of a QSST is quite narrowly defined.26 The entire economic interest in such a trust must belong to a single beneficiary for the duration of the beneficiary's life or the shorter term of the trust. The beneficiary's income interest cannot earlier terminate and any distributions of income or corpus must be to that beneficiary. Finally, all of the fiduciary accounting income of the trust must be currently distributed, or required to be distributed, to that beneficiary.

It is thus quite clear that if a shareholder of an S corporation placed some of his stock in a trust for the benefit of a minor child, the trust would not be a qualified Subchapter S trust if the terms of the trust were as follows: the trust is to last for 11 years; all of the trust income is to be accumulated; the independent trustee may make corpus distributions to the sister of the income beneficiary; and, upon the termination of the trust, all of its assets, including the accumulated income, would revert to the creator of the trust. Nevertheless, such a trust could be a permissible shareholder of an S corporation.

Grantor trusts are also permissible shareholders of S corporations.

Grantor trusts are also permissible shareholders of S corporations, provided that all of the trust is treated under the Clifford provisions as owned by "an individual." That permission extends to section 678 trusts. Under that section, one other than the creator of the trust may be treated as the owner of the trust if he has the unilateral power to vest the income (or the corpus) of the trust in himself. If such a power exists over all of the income of the trust, section 678 treats the power holder as the owner of the entire trust for the purpose of taxing him on the trust income—notwithstanding that the corpus of the trust may be distributed to another or may revert to the creator of the trust.

24Regs. section 1.1502-76(d).
26C.R. section 1361(d)(3).
Notwithstanding this treatment of the power holder as the owner of the entire trust for these income tax purposes, it might be argued that the trust described above nevertheless was not a permissible shareholder of an S corporation because the beneficiary did not in fact own the entire trust within the meaning of section 1361(c)(2)(A)(i). That section, however, only requires that the trust be treated as owned by a single individual and that section 678 does. Accordingly, the Service has ruled privately that a short term section 678 trust may be a permissible shareholder of an S corporation.29

Of course, to obtain section 678 treatment, the beneficiary must have the power to withdraw all of the income of the trust currently. But the “income” that the power holder has the right to withdraw can only be the “income” that the trust has available to distribute. If the only asset of the trust is stock in an S corporation, that “income” can only extend to distributions from the corporation—and not to the taxable income of the S corporation that is allocable to the trust. Thus, if the S corporation does not make any distributions, there will be nothing for the power holder to withdraw upon the annual exercise of his right. And, if the balance of the stock is owned individually by the creator of the trust or members of his family, the making or not of distributions can be entirely controlled. As a result, it is entirely possible to give the income beneficiary a right to demand the distribution of all trust income but to ensure that no economic benefit will ever be obtained by the beneficiary. Upon the conclusion of the trust term, the corpus of the trust, stock in the S corporation—including the increase in value that has been taxed to the income beneficiary of the trust under section 678—will revert to the creator.

The attempt to isolate it from tax planning has left Subchapter S unusable in too many legitimate contexts.

If such a short term trust is in fact a permissible shareholder of an S corporation, there will be few instances in which it will be necessary to use the tightly restricted qualified Subchapter S trust. The section 678 trust is a far more flexible vehicle. That observation brings us to the point of this example.

In either its present form or the modestly simplified version currently being considered in Congress, the Code is an enormously complicated body of law that in large measure is designed to encourage complex tax planning. Subchapter S, with its technical and elaborate procedural requirements, is very much a part of that Code. If S corporations are to be made usable by a significant number of taxpayers, Subchapter S must interact with other provisions of the Code and that interaction will result in devices that manipulate tax liability.

The attempt to sanitize Subchapter S, to isolate it from the tax planning that surrounds every other aspect of the tax laws, has left Subchapter S unusable in too many legitimate contexts. On the other hand, the attempt has not been successful. Even with a highly restrictive definition of small business corporations, avenues of tax planning, or manipulation, exist.30 The unavoidable conclusion is that it is simply not possible to subject S corporations to a pattern of taxation that does not reflect the existing Code if it is to be made available to taxpayers whose other financial affairs are fashioned by the requirements of the Code. In fact, if Congress focused upon specific potential abuses of Subchapter S rather than upon over broad prohibitions, those abuses could be more effectively curtailed.

C. Towards a Solution

Many of the flaws in Subchapter S considered above could be eliminated through further discrete technical amendments as has occurred repeatedly in the past. A mid-year election procedure, for example, would be quite simple to enact. History suggests, however, that a series of ad hoc amendments is not the path to rationality. Moreover, given the present conservative approach to the definitional provisions of Subchapter S, even simple provisions tend to produce ancillary complexity. Thus, it was suggested above that mid-year elections should not be allowed to C corporations unless the election remained in effect for a prescribed period—a rule to which the usual complicating exceptions would undoubtedly be necessary. Plainly, broader based reform would be desirable.

When Subchapter S was originally enacted in 1958 it was regarded with understandable suspicion by both the Congress that enacted it and the Treasury Department that administered it. At the time, the elimination of the corporate level tax was a radical step. What was undoubtedly viewed as a substantial subsidy to small business—today we would call it a preference—was to be kept tightly controlled. Accordingly, when Congress became concerned that the new conduit entity might be abused, it adopted the most restrictive solutions.

After a quarter of a century, Subchapter S is no longer regarded as a pernicious influence upon an otherwise rational Code; many would argue that the single level of tax it produces is superior in principle to the taxation of nonelecting corporations. Moreover, it has now become clear that the restrictive original solutions to feared abuse were both unnecessary to the protection of Subchapter S and harmful to the legitimate use of S corporations. To date, the congressional response to this changing perception of the S corporation has been both too limited and inappropriately designed. The grant of remedial ruling authority in limited areas is not a sound substitute for the development of reasonable provisions. Rather, an exploration of the least restrictive alternatives compatible with the objectives of Subchapter S is long overdue.

An S corporation could be made as flexible and useful a vehicle for investment as is a partnership. If regular corporations, S corporations, trusts, and other partnerships may own interests in partnerships and partnerships can own interests in regular corporations, trusts, and
other partnerships, there is no inherent reason why a partnership—or a trust or a corporation—cannot own an interest in an S corporation. There is, however, one specific reason why S corporations continue to be regarded with a suspicion that has caused the Congress to treat them differently from other conduit entities.

The one characteristic of the income of an S corporation that distinguishes it from other sources of income is that it may be attributable to the continued investment of earnings and profits derived by the corporation in non-electing years. One of the most striking features of Subchapter S is the extreme ease of entry and exit from its provisions. With only the most trivial of exceptions, there is no tax cost to either electing under Subchapter S or revoking that election. In principle, income accumulated during nonelecting years remains subject to the same overall rate of tax as would have been imposed in the absence of an election because even distributions by an S corporation out of earnings and profits are subject to a second, shareholder level tax upon distribution. However, a Subchapter S election permits the income generated by the investment and reinvestment of those earnings to escape double taxation before those earnings and profits have been taxed at the shareholder level. The general effect of this aspect of Subchapter S is the same as permitting the pre-election earnings and profits to be removed from corporate solution without the imposition of tax.

**An S corporation could be made as flexible and useful a vehicle for investment as is a partnership.**

This highly favorable treatment of S elections by C corporations most clearly appears when contrasted with the burden of tax that would be imposed had the corporation chosen instead to form the other conduit business entity, a partnership. Upon the liquidation of the C corporation, some tax would be imposed at the corporate level. More significantly, the shareholders would either be subject to tax at capital gains rates on the full value of the corporation under section 331 or an amount equal to the entire earnings and profits of the corporation would be subject to tax at ordinary rates under section 336. In the former event the shareholders receive a basis in the assets distributed equal to their fair market value; in the latter case the basis for the assets is substituted from the basis in the stock of the liquidated corporation.

Neither tax is imposed upon the making of an S election. Rather, the general effect of the election is similar to a section 333 liquidation with the tax on the corporate earnings deferred, perhaps indefinitely.

Similarly, the termination of the S election does not involve income tax consequences. While the incorporation of a partnership must pass through the safeguards of sections 351 and 357, no such provisions apply to the termination of the election. Thus, for example, the termination of an S election does not result in a tax liability notwithstanding that the liabilities of the corporation exceed the basis of its assets (because losses have been passed through to the shareholders) while that excess would be subject to immediate tax upon the incorporation of a partnership.

**The propriety of this freedom to move in and out of Subchapter S is highly questionable.**

The propriety of this freedom to move in and out of Subchapter S is highly questionable in principle and has opened major avenues of abuse in practice. Those possibilities, in turn, have precipitated the enactment of several provisions in Subchapter S that are designed to prevent the abuse of Subchapter S by corporations. And, of present concern, the potential presence of earnings and profits in an S corporation has caused Congress to restrict the availability of Subchapter S through narrow and technical definitional requirements.

Congress has been willing to pay this price in sacrifice of principle and enhanced complexity because it wanted to make S corporation status freely available to previously incorporated businesses. While that desire may have been sensible in 1958, it may not be sensible today. Few corporations formed prior to 1958 wish to elect under Subchapter S today and those formed after that date had their opportunity to select the form in which they desired to do business. This ease of transformation may no longer be essential to Subchapter S.

A strong argument therefore exists that a corporation having earnings and profits accumulated during non-electing years should not be permitted to elect under Subchapter S until those earnings and profits were purged through the payment of an appropriate shareholder level tax. However, it is entirely possible to preserve this generous feature of Subchapter S while simplifying its provisions for most taxpayers.

The existing statutory framework already contains the seeds of two versions of Subchapter S. Special sections of the subchapter impose a tax upon capital gains and investment income derived by an S corporation that previously was a C corporation. The rules governing corporate distributions apply differently depending upon whether the corporation has earnings and profits. And the regulatory treatment of the two-class-of-stock safe

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harbor may well differ depending upon whether the corporation has earnings and profits.

That dichotomous treatment of S corporations should be expanded to the point of creating two entirely distinct versions of Subchapter S. The existing provisions simply attempt too much; neither corporations having or lacking earnings and profits are defined or taxed optimally. For S corporations having earnings and profits, the rules of current law are already too generous; two versions of Subchapter S would permit those rules to become more restrictive. But of greater present importance, eliminating the deferral of tax on earnings and profits could permit the development of a truly viable S corporation.

During the 1982 revision, Professor Ginsburg argued in these pages for a similar approach as a vehicle for rationalizing and simplifying the substantive provisions, of Subchapter S. Assuming that it would be unwise or unacceptable to impose a substantial tax burden on all corporations having accumulated earnings and profits that wished to elect under Subchapter S, he suggested that a simplified version of S corporation be made available to corporations that lacked earnings and profits or elected the imposition of an appropriate toll charge as the price of the election. To his observations it may be added that a dual Subchapter S may also be the only way to achieve material procedural simplification of those provisions. In common with the substantive taxing provisions he addressed, many of the restrictive definitional and procedural aspects of present law are attributable to the ease of shifting between Subchapters C and S by corporations having earnings and profits. Absent that aspect of S corporations, where would be no justification for treating an S corporation more restrictively than other conduit entities.

Careful consideration, then, should be given to the creation of a category of S corporation that did not have, and could not obtain, earnings and profits attributable to nonelecting years. If this simplified S corporation were permitted to have corporate shareholders, as it should be, it might also be necessary to bar the S corporation from obtaining property from a nonelecting corporation in a carryover basis transaction. The definitional and procedural requirements for such an S corporation could be relaxed greatly. The number and categories of permissible shareholders could be conform to the unlimited flexibility granted to partnerships. As a result, the endless refinements of the definitional provisions now evolving in the private rulings would become unnecessary. The prohibition against wholly owned subsidiaries could be repealed. These changes, in turn, virtually would eliminate the problem of involuntary terminations of S elections. Other aspects of present law, such as the timing of elections and the one class of stock requirement, could be liberalized. And, of course, the substantive simplifications noted by Professor Ginsburg could be extended to such a corporation.

An existing C corporation having earnings and profits could obtain the benefits of this simplified category of S corporation only by electing to subject its shareholders to a tax liability that would purge those earnings and profits. Opinions may differ on the proper level of that tax liability. Professor Ginsburg suggested that each shareholder be taxed on an amount equal to the excess of his share of the inside basis for the corporate assets over the basis for his stock and that the tax be imposed at capital gains rates. Such a tax would approximate a tax limited to the earnings and profits of the corporation (as under section 331) but imposed at the preferential rate (as under section 331) and thus would be far more favorable than is the tax imposed at the shareholder level upon an actual liquidation. If the toll charge was not to be imposed with respect to the entire value of the stock in the electing corporation, it would be more consistent with the existing pattern of taxing liquidations and other corporate distributions to impose the tax at ordinary income rates.

Corporations having earnings and profits but not electing to become subject to whatever tax were ultimately determined appropriate would, of course, remain subject to the more restrictive procedural and substantive rules of present law. In fact, given an alternative S corporation format, some of the accommodations of present law properly might be eliminated. The complexities of the qualified Subchapter S trust and of safe harbor debt might be repealed and the prohibitions against “one shot” elections strengthened.

Such a dual approach to Subchapter S might finally permit the evolution of a widely available conduit corporate entity free of both the procedural and substantive restrictions that have crippled its predecessors.

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\[34] R.C. section 1361(c)(5) bars treating certain debt instruments as stock. Thus, this safe harbor debt cannot be treated as a second class of stock which would terminate the S election.  
\[36] Perhaps neither S corporations nor partnerships should be entitled to some of the more flexible features of Subchapter K.

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