

EXAMPLE 15.14

Salz Company made a cash distribution of \$25,000 on June 3, 2012. Its accumulated E&P on January 1, 2012, was a negative \$10,000 and its current E&P for 2012 was a negative \$17,000. The \$25,000 is not treated as a dividend. It is a return of capital.

6. The corporation's current E&P is negative but its accumulated E&P is positive. Since accumulated E&P is used up on a chronological basis, the accumulated E&P is netted with current E&P at the date of distribution. The negative current E&P is allocated ratably during the year; thus, it is prorated to a distribution based on the number of days in the tax year to the date of the distribution. This procedure assumes that the negative E&P occurred evenly throughout the tax year. If the corporation can show when the actual deficit occurred, then it may use that date for allocating the negative current E&P.

EXAMPLE 15.15

On January 1, 2012, Cote's Corporation has accumulated E&P of \$15,000. Its current E&P for 2012 was a negative \$10,950. It made two cash distributions of \$6,000 each on April 1 and July 1. The status of these distributions is as follows. The negative current E&P is allocated on a daily basis of \$30 (\$10,950/365).

Distd.	Total Distr.	Pro rata Portion of Current E&P	Accumulated E&P on Distribution Date	Taxable Amount	Return of Capital
Apr. 1	\$6,000	(\$2,700)	\$15,000 - \$2,700 = \$12,300	\$6,000	\$0
July 1	\$6,000	(\$5,430)	\$15,000 - \$6,000 - \$5,430 = \$3,570	\$3,570	\$2,430

On April 1 the pro rata portion of current E&P is a negative \$2,700 (\$30 x 90 days). Since accumulated E&P minus current E&P is greater than the distribution, the distribution is taxable. On July 1, the pro rata portion of current E&P is a negative \$5,430 (\$30 x 181 days). Only \$3,570 is left in accumulated E&P after subtracting the April 1 dividend and the current E&P on July 1 from beginning accumulated E&P.

At this point, accumulated E&P is zero and any other distributions in 2012 would be returns of capital. If no other distributions are made in 2012, then accumulated E&P on January 1, 2013, would be a negative \$5,520 (the zero balance in accumulated E&P at July 1, 2012, plus the remaining deficit of \$5,520 in current E&P). If there is more than one shareholder, then E&P is allocated to each shareholder. (\$8130)?

EXAMPLE 15.16

Newman Corporation has accumulated E&P of \$10,000 on January 1, 2012. Its current E&P for 2012 is \$50,000. It made cash distributions of \$40,000 each on May 1 and November 1. On January 1, 2012, Newman had two shareholders, Lisa and Reece. Each owned 100 shares which they acquired in 2005. Lisa's adjusted basis of her stock was \$35,000 and Reece's was \$19,000. On October 15, 2012, Susan bought 50 shares from Reece for \$18,000. The results of these events are as follows:

$$\frac{\text{Current E\&P}}{\text{Total distributions}} = \frac{\$50,000}{\$80,000} = \frac{5}{8} = \text{Portion of each distribution from current E\&P}$$

$$\text{May 1 distribution: } \$40,000 \times \frac{5}{8} = \$25,000 \text{ from current E\&P}$$

$$\text{November 1 distribution: } \$40,000 \times \frac{5}{8} = \$25,000 \text{ from current E\&P}$$

The \$10,000 accumulated E&P is used up by the May 1 distribution; thus, \$35,000 (\$25,000 + \$10,000) of the May 1 distribution is a dividend and \$25,000 of the November 1 distribution is a dividend.