

Financial, Legal & Tax Advisory

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Electing S Corporation Status

It isn't exactly a secret that taxpayers and business owners consistently look to pay as little money as possible to the federal government. Whether they use tax deductions, tax credits, or any other means of reducing their tax burden, when it comes to business owners, one way to do this is to evaluate the taxation structure of your business entity. There are several different options, such as sole proprietors (where income is reported on an individual's Schedule C) or partnerships (where income is reported on a business' Form 1065).

Other individuals, however, may find it more beneficial to elect corporation status with the Internal Revenue Service to effectively minimize tax burdens. When making an election to become a corporation, you can elect to either become a C Corporation or S Corporation. This advisory will focus on S Corporation elections. S corporations are corporations that elect to pass corporate income, losses, deductions, and credits through to their shareholders for federal tax purposes.

The shareholders of S corporations then report the flow-through of income and losses onto their personal tax returns where they are accessed tax at their individual income tax rates. This gives S corporations the ability to avoid double taxation on their corporate income. S corporations are responsible for tax on certain built-in-gains and passive income at the entity level. There are certain requirements to qualify for S corporation status:

- Be a domestic corporation
- Only allowable shareholders
- Can be individuals, certain trusts, and estates and
- Cannot be partnerships, corporations, or non-resident alien shareholders

- Have no more than 100 shareholders
- Only one class of stock
- Not be an ineligible corporation (certain financial institutions, insurance companies, and domestic international sales corporations)
- File Form 2553 (election by a Small Business Corporation) As noted above, one S corporation cannot own another. However, there is a workaround for this. A parent S corporation can use Form 8869 to elect that it treats one or more of its eligible subsidiaries as a qualified subchapter S subsidiary, known as a QSub. This QSub election results in a deemed liquidation of the subsidiaries into the parent corporation. Following said deemed liquidation, the QSub is not treated as a separate corporate entity and all the subsidiary's assets, liabilities, and items of income, deduction, and credit become treated as those of the parent.

Some advantages of choosing S Corporation elections are:

- Corporate Tax Savings
- Personal Income Tax Savings
- Distributions (ability to be tax-free)
- Simplification of Asset Transfers

Some disadvantages of choosing S Corporation elections are:

- IRS Scrutiny
- Distribution Rules
- Shareholder Restrictions
- Fees
- Limitations on Growth

If you happen to own or plan on owning a small business and have any questions on your entity classification, reach out to the professionals at The Center for Financial, Legal, and Tax Planning by contacting us online at www.taxplanning.com or calling us at (618) 997-3436.

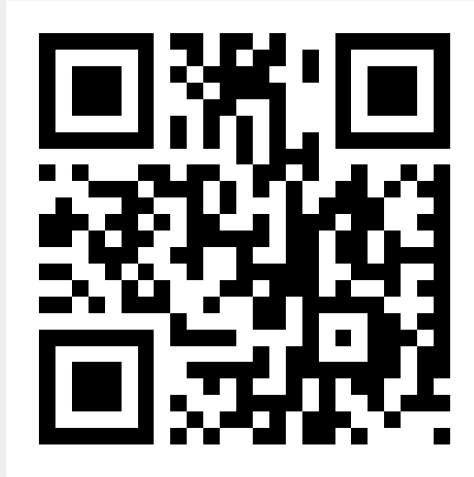
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