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IRSNationwide

TaxFORUM

# The S-Corporation Election; Advantages & Disadvantages



Presented by:  
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# Learning Objectives

At the end of this course, you will be able to:

- Define the advantages of being taxed as an S-Corp
- Recognize the difference of taxation as a S-Corp compared to a C-Corp
- Understand how profit distributions and payroll are taxed in a S-Corp
- Determine if this is a good tax entity choice for your client
- Learn how to make the S-Corp election



# What Is The Sub-S Election?

- Chapter 1 Subchapter S of Internal Revenue Code
- Who can make the election?
  - Meet the 5 requirements of IRC §1361 (b)
  - Domestic Corporations
  - Disregarded entity - LLC's
- Previously an S-Corp, 5 year rule



# Is this the right entity for your client?

- Advantages:
  - Liability protection
  - Separate entity
  - Perpetual Life
  - Personal Service Corporation issues
  - Shareholder Agreement



# Is this the right entity for your client?

- Disadvantages:
  - Discipline
  - Expense
  - Filing requirements
  - Late filing fees
  - Calendar year restrictions



# S Corporation Stock

- Advantages:
  - IRC §1367 requires annual adjustment
  - Raise capital through stock issuance
  - One class of stock
  - Ordinary loss on sale IRC §1244
  - Capital gain treatment on sale
  - Voting vs non-voting



# S Corporation Stock

- Disadvantages:
  - Who is keeping track of stock basis?
  - Debt can create second class of stock
  - Stock sale doesn't qualify for IRC § 1202
  - Basis reduction
  - Disproportionate distributions



# Shareholders

- Advantages:
  - 100 limit, family members treated as one shareholder
  - US citizen or resident individual
  - Estates, certain trusts and charities
  - Deductibility of acquisition interest
  - Favorable charitable contribution rules



# Shareholders

- Disadvantages:
  - Limitations of shareholders
  - Limitation to raise outside capital
  - No fringe benefits for 2% shareholder
  - K-1 reporting
  - Basis complexity



# Pass through Entity

- Advantages:
  - Taxation at individual level
  - Losses flow through
  - No double taxation
  - Capital gains & losses flow through
  - If active participation by shareholder, profits are not subject to NIIT



# Pass through Entity

- Disadvantages:
  - Profits are taxed even when not distributed
  - Losses are limited to tax basis
  - Individual tax rates
  - IRC §179 limitations



# Reasonable Salary

- Advantages:
  - Retirement funding
  - Minimize risk of excessively high salaries
  - Splitting income with family members
  - Minimize risk of hobby loss
  - Minimize risk of recharacterization



# Reasonable Salary

- Disadvantages:
  - For adequate services provided
  - Must actually be paid
  - Payroll taxes
  - IRS scrutiny as to "reasonable"



# Distributions

- Advantages:
  - IRC §1368
  - E & P distributions are taxable dividends
  - No E & P, profit distributions are tax free to the extent of basis
  - Not mandatory



# Distributions

- Disadvantages:
  - Must be equitable to all shareholders
  - E & P dividend distributions – lower tax rate for individuals
  - No E & P distributions in excess of basis - taxable capital gains



# S Corporation taxes

- Excess Net Passive Income (ENPI) Tax  
IRC §1375
- Built in Gains (BIG) Tax IRC §1374
- Inventory – LIFO vs FIFO IRC §1363
- Investment Credit Recapture
- Avoid Accumulated Earnings Tax



# Making the Election

- Form 2553
  - All shareholders must consent
  - Community Property States! Rev. Proc. 2004-35
- Form 8832
- Corporation late election
- Rev. Proc. 2013-30
- Combined entity & S election



# Other factors to consider

- LLC & sole prop alternative
- Termination – IRC §1362
- Revoking S Status
- Shareholder Agreement
- Inadvertent Termination
- Separately stated items



# WHAT?!?

What we learned in the last hour:

- We defined the advantages of the S-Corp
- We can recognize the difference in taxation as a S-Corp compared to a C-Corp
- We now understand how profit and distributions are taxed in a S-Corp
- We know the issues and questions to ask to determine if this is a good tax entity choice for our client
- We learned how to make the S-Corp election



# For More Information National Society of Accountants

More information is available including  
additional materials at:

Booth in Vendor Hall

Or Table in Lobby

800-966-6679

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