

INTERNAL REVENUE SERVICE



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We are responding to your correspondence requesting information about the tax benefits of incorporating and electing S corporation status.

A sole proprietorship is an *unincorporated* business that is owned by one individual and it has no existence apart from the owner who assumes *personal liability* and undertakes business risks for all assets owned, whether or not used in the business.

Alternatively, in forming a corporation, prospective shareholders transfer money, property, or both, for the corporation's capital stock. A corporation generally takes the same deductions as a sole proprietorship to figure its taxable income; however, a corporation can also take *special deductions*. The profit of a "C" corporation is taxed to the corporation when earned, and then is taxed *again* to the shareholders when distributed as dividends. However, shareholders *cannot* deduct any loss of the corporation.

An eligible domestic corporation can avoid C corporation *double taxation* as described above by electing to be treated as an S corporation. An S corporation generally is exempt from federal income tax other than tax on certain capital gains and passive income. Its shareholders include on their tax returns their share of the corporation's separately stated items of income, deduction, loss and credit, and their share of non-separately stated income or loss. Basically, an S corporation does not pay income tax, but rather the corporation's income and deductions are *divided among and passed onto the shareholders*. The shareholders then report the income and deductions on their personal returns, and the S corporation files an annual return on Form 1120S by the 15<sup>th</sup> day of the third month after the close of the tax year (e.g., 12/31/99 year end return was due on 3/15/2000). Generally, the tax year of an S corporation must be a calendar year, January 1 through December 31.

Please refer to the enclosed *Instructions for Form 2553* for **important** information about electing S corporation status, and Publication 583 for guidelines about starting a business and keeping records. Typically, taxpayers are notified of acceptance or nonacceptance of their S corporation election within three months of date of filing (date mailed). If the IRS questions whether the election was filed, **acceptable proof of filing** is (a) *certified or registered mail receipt*, (b) Form 2553 with an accepted stamp; (c) Form 2553 with stamped IRS received date; or (e) an IRS letter stating the election has been accepted.

If you are going to incorporate your business, you will incur Colorado filing and licensing fees, depending on the type of business you operate. For further information about establishing and conducting a business in the state of Colorado, call the Colorado Secretary of State at (303) 894-2200, or visit their website at [www.sos.state.co.us](http://www.sos.state.co.us). Further, you might find it beneficial to retain an attorney specializing in corporate law or small business development to assist you with the incorporation process.

You must file Form SS-4, Application for Employer Identification Number, which can be accomplished by calling Tele-TIN at (801) 620-7645. Refer to the enclosed Form SS-4 and related instructions for more specific information. We are also providing a copy of *Publication 2053*, Quick and Easy Access to IRS Tax Help and Forms which discusses various means whereby you can access helpful tax information.

Please keep this letter with your tax records and feel free to provide a copy of it to your authorized representative. We hope that the above information proves helpful.

Sincerely yours,

**/s/Dianna K. Miosi**

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Enclosures:  
As Stated