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S Corporation Election Considerations for Corporations and LLCs

Presented by
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A pioneer in the online legal document filing space since 1997, Nellie has helped more than half a million small businesses and licensed professionals start and maintain companies across the United States, most recently through her Inc.5000 recognized company, CorpNet. She closely follows trends in the industry and shares her wealth of knowledge across various CPA and small business communities, establishing Nellie as one of the most prominent influential experts on business startup and compliance matters.

Agenda and Goals

In this session, we will review how the S Corporation election differs for Corporations, LLCs, and within various states.

- What is the S Corporation
- S Corporation treatment for Corporations
- S Corporation treatment for LLCs
- S Corporation Election at the State Level
- How to Become an S Corporation
- 2025 S Corporation Election Deadlines
- Operating as an S Corporation

The S Corporation

What is an S Corporation?

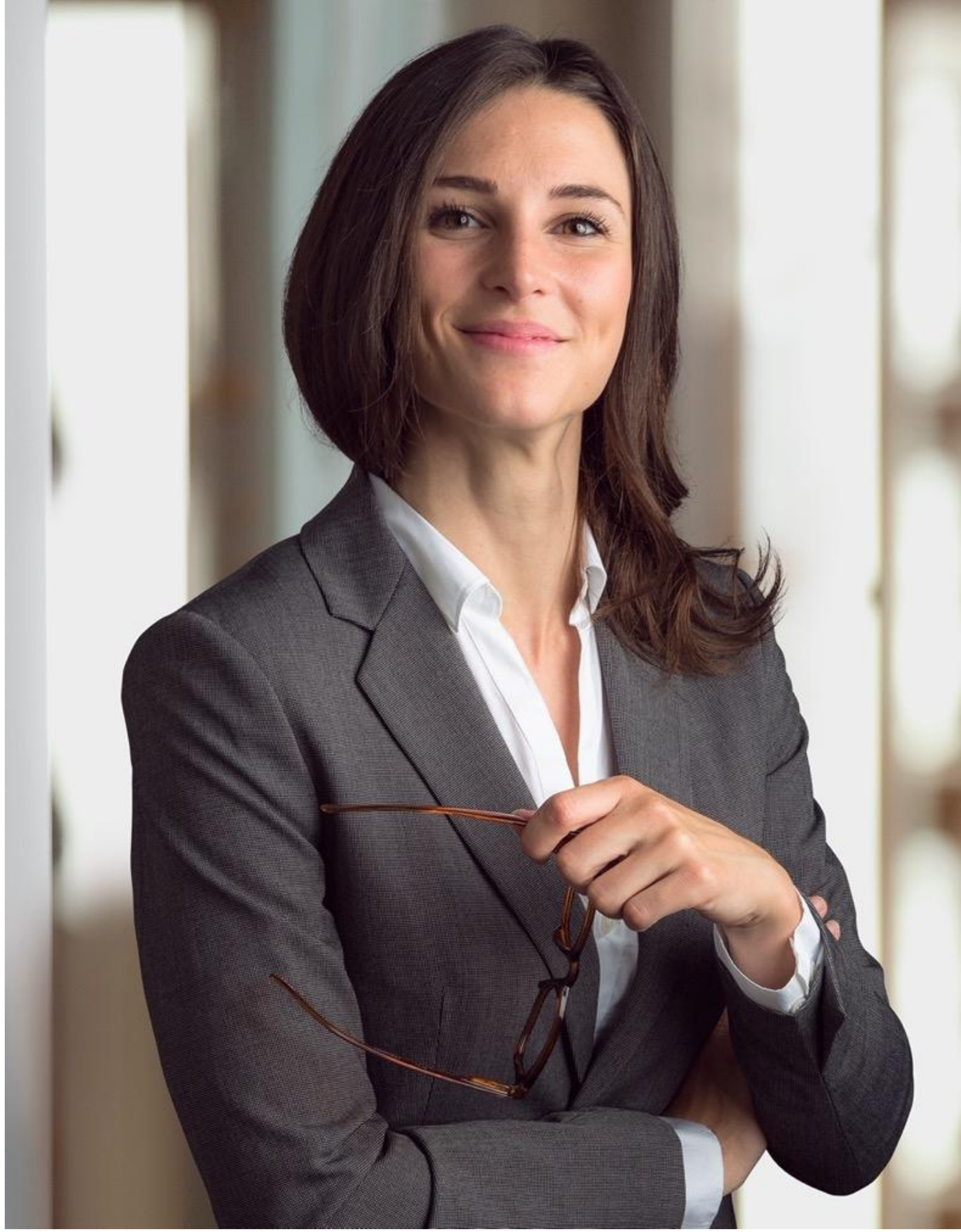
- Not a type of business entity
- Special tax election for eligible Limited Liability Companies (LLCs) or Corporations
- Business owners must decide whether a company will be registered as LLC or Corporation before electing S Corporation treatment
- IRS has issued eligibility requirements for S Corporation status

Understanding the Difference

The potential advantages of electing S Corporation tax treatment are a bit different for LLCs and Corporations.

- Crucial to consider the differences when deciding whether to form an LLC or Corporation to obtain S Corporation status
- Critical to understand the differences between the LLC and Corporation business entity types
- Aside from tax implications, there are legal and administrative factors to consider

S Corporation Treatment for Corporations



Overview of a Corporation

- Separate legal and tax-paying entity
- Highest level of protection
- Can sell company stock and offer stock options
- Unlimited number of shareholders

Starting and Running a Corporation

- More involved and costly than forming an LLC
- Several legal steps to get started
- Comply with ongoing compliance and tax requirements

Default Tax Treatment of a Corporation

- Profits and losses flow through to corporate tax return
- Taxable income taxed at corporate rate
- Some businesses undergo double-taxation
- Dividends to shareholders are taxable

S Corporation Tax Treatment for Corporations

- Avoids double-taxation
- Profits and losses flow through to shareholders' personal tax return
- Corporation itself does not pay income tax

Does an S Corporation Election Make Sense for Your Clients' Corporation?

- It can depend on client's business goals. If the plan is to sell the business, forming a Corporation and electing S Corporation status could be a benefit
- If your client has a business in a dangerous industry, a corporate formation is a better idea due to higher legal protection
- A Corporation with S Corporation election benefits small businesses where the shareholders want greater liability protection, want to be on payroll and take out a reasonable salary, and do not want to be taxed twice

A Corporation with S Corporation election benefits small business owners where the shareholders:

Polling Question #1

- Want greater liability protection
- Want to be on payroll and take out a reasonable salary
- Do not want to be taxed twice
- All of the above

S Corporation Treatment for LLCs

Overview of a Limited Liability Company (LLC)

- Separate legal entity
- Liability protection
- Less rigid compliance requirements

Starting and Running an LLC

- Affordable and “simple” to file
- Handful of legal steps to get started
- Comply with ongoing compliance and tax requirement

Default Tax Treatment of LLCs

- IRS does not consider separate tax-paying entity
- Pass-through entity
- Subject to self-employment tax

S Corporation Tax Treatment for LLCs

- Eliminates self-employment tax at shareholder level
- Salary must be fair compensation or red flag for IRS
- More flexible than C Corporation option

Does an S Corporation Election Make Sense for Your Clients' LLC?

- If your client is looking to avoid many formalities of a C Corporation (Minutes, Board of Directors, Annual Meetings, etc.) an LLC with S Corporation election would be a good fit
- If a client is looking to stay in business long-term, an LLC with S Corporation election could be a wise choice
- An LLC owner that elects to file as an S Corporation would take payroll instead of guaranteed payments, limiting self-employment tax, which could be appealing to many clients
- Forming an LLC with S Corporation election is a wise choice if your client intends to file as a partnership or sole-proprietor in the future

Weighing the Options

- Clients in the real estate industry should typically operate as an LLC due to distributing property to the individual's tax free, but it is a taxable event if distributed through an S Corporation.
- Talk with your client about how they want to present their company publicly. Having an LLC vs an Inc at the end of a business name can make an impact, however, this does not change based on how taxes are filed.
- If you and your client are unsure about the best option, consider forming an LLC. You can always incorporate later. However, if you incorporate first and later decide an LLC is best, a lot more work is involved.

S Corporation Election at the State Level

Many States Have Different Rules

- S Corporation election benefits can change at the state vs federal level.
- Most states are given S Corporation pass-through tax treatment, but there are exceptions.
- Critical that clients understand how this affects their business.

State-Level S Corporation Election Requirements: New Jersey

- State-level S Corporation tax treatment requires filing Form CBT-2553.
- The state will only consider the election valid if all of the Corporation's shareholders consent to the election and other state requirements.

State-Level S Corporation Election Requirements: New York

- New York state does not automatically treat a company as a New York S Corporation unless mandated to file as an S Corporation under Tax Law Section 660(i).
- New York requires a Corporation to file form CT-6 to apply for S Corporation tax treatment at the state level.

State-Level S Corporation Election Requirements: Arkansas

- It was not until 2018 that Arkansas recognized S Corporation tax treatment at the state level without additional paperwork.

State-Level S Corporation Election Requirements: Utah

- Utah requires a copy of a company’s Notice of Acceptance as an S Corporation from the IRS.
- The notice must be attached to Form TC-20S the first time the company files its tax return.

Where S Corporation Flow-Through Tax Treatment Does Not Exist

Some jurisdictions do not recognize S Corporation election. Tax agencies in the following areas do not grant pass-through taxation for Corporations that have been approved for federal S Corporation tax treatment.

- District of Columbia
- Louisiana
- New Hampshire
- New York City
- Tennessee
- Texas

States Without Personal or Corporate Income Taxes

S Corporation election is essentially a non-issue in some areas as there are no state income taxes at the personal or corporate level.

Note: some of these states, however, may enforce other types of fees to an S Corporation or its shareholders.

- Alaska
- Florida
- Nevada
- South Dakota
- Washington
- Wyoming

Which state recognized S Corporation tax treatment without additional paperwork as of 2018?

- New Jersey
- New York
- Arkansas
- California

Polling Question #2

How to Elect S Corporation Status for a Corporation or LLC

S Corporation Election Deadline

- Form 2553 must be filed no later than two months and fifteen days after the start of the tax year in which the S Corporation will take effect. For most businesses, the tax year begins on January 1, so the filing deadline would be March 15 (outside of leap years or if it falls on a weekend or holiday).
- Missing the deadline means the business will continue to be taxed as a C Corporation or LLC for the remainder of the tax year, with S Corporation treatment starting on January 1st of the following year.
- Newly formed LLCs and Corporations have two months and 15 days (75 days) from their date of formation to file for S Corporation election for the tax year.
- Business owners can request a six-month extension to file for S Corporation status by filing IRS Form 7004.

Eligibility for S Corporation Status

To qualify for status, a Corporation or LLC must meet the following requirements:

- Be a domestic Corporation
- Have only allowable shareholders
  - May be individuals, certain trusts, and estates and
  - May not be Partnerships, Corporations, or non-resident alien shareholders
- Have no more than 100 shareholders
- Have only one class of stock
- Not be an ineligible Corporation - certain financial institutions, insurance companies, and domestic international sales corporations
- Submit Form 2553 Election by a Small Business Corporation signed by all shareholders by the March 15th deadline (outside of leap years or if it falls on a weekend or holiday)

Steps to Elect S Corporation Tax Status

1. Entity must first be incorporated as a C Corporation or have filed as an LLC.
2. A C Corporation electing S Corporation status must submit and file IRS form 2553 signed by all shareholders.
3. An LLC electing S Corporation status must submit and file IRS form 2553 signed by all shareholders.
4. An LLC electing to be taxed as a C Corporation must submit and file IRS Form 8832 signed by all shareholders.

What if the S Corporation Deadline is Missed?

- If a Corporation or LLC fails to timely file its IRS form 2553 with the IRS, the S Corporation election will NOT be effective for that year.
- A Corporation will be taxed as a C Corporation.
- A single-member LLC will be taxed as a disregarded entity and a multi-member LLC will be taxed as a Partnership.
- A late S Corporation election is generally effective for the next tax year. Relief for late election may be available if the Corporation or LLC can show that the failure to file on time was due to reasonable cause.

Which form is needed to elect S Corporation status?

- Form 1098
- Form 2553
- Form 1099
- Form 1065

Polling Question #3

Operating as an S Corporation

How Clients Pay Themselves

To avoid red flags for the IRS:

- An S Corporation shareholder who does substantial work for the S Corp is considered an employee of the corporation and must take a reasonable salary from the corporation on payroll.
- The business must put the shareholder on payroll and compensate the shareholder through a reasonable salary - from which taxes are withheld
- An S Corporation's profits are taxable at the shareholder level. Distributions of these profits can be made to shareholders tax free.

How Clients Pay Themselves

To avoid red flags for the IRS:

- S Corporation owners can run into trouble if they pay themselves a suspiciously small salary and then take most of their compensation in the form of distributions to minimize the amount of taxes they have to pay.
- The IRS can revoke an S Corporation status of they determine shareholders are substantially underpaid for the services they provide.
- It is critical to maintain and track shareholder basis in an S Corporation. Tax free distributions can be made to the shareholder as long as there is sufficient basis. Shareholder basis has increasingly become an examination area by the IRS.

Home Office Deductions Options

- If you are an employee of your own S Corporation, you have a couple of choices for handling the costs of a qualifying home office:
  - The S Corporation can pay you rent for the home office.
  - The S Corporation can pay you for the costs of a home office under an "accountable" plan for employee business expense reimbursement.
- Being reimbursed under an accountable plan provides the greatest tax savings, because it offers a way to get money out of your S Corporation tax-free. The corporation can deduct the amount of the reimbursement and you do not have to report the payment on your personal income taxes.
- This option is better than having the corporation pay you rent for the home office. While your corporation can deduct the rent paid to you, you must report the rent as income on Schedule E.

Qualifying for Home Office Deductions

- To qualify as a home office, the space (it does not have to be an entire room) must be used regularly (on a continuous, ongoing or recurring basis) and exclusively (there can be no personal use) for your trade or business, and it must be your principal place of business or a place where you physically meet with patients, clients or customers on a regular basis.
- The space will be considered your principal place of business if it is used for performing administrative or management activities, such as billing, bookkeeping, ordering supplies, setting up appointments and writing reports, and there is no other fixed location where you regularly perform these activities.

Qualifying for Home Office Deductions

- As an employee of the S Corporation the home office must be for the convenience of your employer. This means the home office is required as a condition of employment, it is necessary for the business to function, or it is necessary for you to properly perform your duties as an employee. If you do not have any other place of business, such as a rented office or storefront, your home office should qualify.
- For an expense reimbursement plan to be considered "accountable," the expenses that are reimbursed must be for actual job-related expenses and you, as the employee, must substantiate the expenses by providing your employer with receipts or other documentation.

Allowable Home Office Deductions

- Real estate taxes
- Homeowner's insurance
- Heat and electric
- Water and sewer
- Alarm or security service
- Garbage disposal
- General repairs and maintenance
- Mortgage interest

Ongoing Compliance Requirements

	Initial Filing Requirements	Annual Compliance Requirements	Registered Agent Required
C Corporation	Initial Filing (some states) Initial Report (some states) Publication Fees (some states)	Annual Reports Annual Meetings Meeting Minutes	Yes
S Corporation	Initial Filing (some states) Initial Report (some states) Publication Fees (some states)	Annual Reports Annual Meetings Meeting Minutes	Yes
Limited Liability Company	Initial Filing (some states) Initial Report (some states) Publication Fees (some states)	Annual Reports	Yes

The IRS can revoke an S Corporation status if they determine what?

- Shareholders are substantially underpaid for the services they provide.
- Shareholders are substantially overpaid for the services they provide.
- Shareholders are paid late for the services they provide.
- Shareholders are paid a reasonable salary for the services they provide.

Polling Question #4

Helpful Resources

CorpNet Tools Are Your Resources

- Business Name Search Tool
- Interactive Business Structure Wizard Tool
- CorpNet Compliance Portal With Monitoring and Proactive Alerts
- Annual Meeting Minutes Services
- Business Guides and Checklists
- The CorpNet Blog

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