

COVERING YOUR CLIENT'S

S CORPORATION

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AGENDA

- ELIGIBILITY RULES
- TAXATION OF CORPORATE OPERATIONS
- THE IMPORTANCE OF BASIS
- S CORPORATIONS WITH A C CORPORATION PAST
- DISTRIBUTION RULES
- PLANNING IDEAS

ELIGIBILITY RULES



**DOMESTIC
CORPORATION**



**UP TO 100
SHAREHOLDERS
(NO ENTITIES)**

TRUSTS AS S CORPORATION SHAREHOLDERS

**QUALIFIED
SUBCHAPTER
S TRUST**

**ELECTING
SMALL
BUSINESS
TRUST**

**GRANTOR
TRUST**

**FORMER
GRANTOR TRUST
or
TESTAMENTARY
TRUST**

ELIGIBILITY RULES



**DOMESTIC
CORPORATION**



**UP TO 100
SHAREHOLDERS
(NO ENTITIES)**



**U.S. CITIZENS &
LEGAL RESIDENTS**



**ONE CLASS
OF STOCK**

TAXATION OF CORPORATE OPERATIONS

- All items of income, gain, loss, deduction, and credit pass through to shareholders *pro rata*
- Flavor of pass-through items determined at entity level



THE IMPORTANCE OF BASIS

- Shareholder's share of S corporation net loss deductible to extent of stock/debt basis

Ideas to Create More Basis

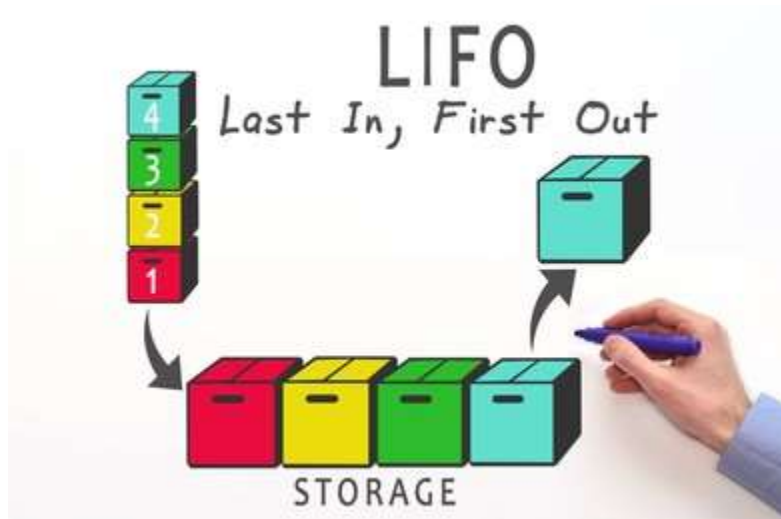
- (1) Shareholder loans
- (2) Purchase co-owner's shares for note

- Pass-through items adjust stock basis
 - Increased by INCOME ITEMS
 - Decreased by DISTRIBUTIONS
 - Decreased by NON-DEDUCTIBLE EXPENSE
 - Decreased by DEDUCTION AND LOSS ITEMS

"It's all about that basis, 'bout that basis."

- Meghan Trainor

S CORPORATIONS WITH A C CORPORATION PAST



LIFO RECAPTURE

DOUBLE TAXATION



**§1374 TAX ON
NET RECOGNIZED
BUILT-IN GAIN**



**§1375 TAX ON
EXCESS NET PASSIVE INCOME**

DISTRIBUTION RULES

“PURE” S CORPORATIONS

- Tax-free to extent of stock basis
- Excess = capital gain

S CORPS. THAT USED TO BE C CORPS.

- FIRST from **Accumulated Adjustments Account**
 - Tax-free to extent of stock basis
 - Excess = capital gain
- SECOND from **C corporation earnings & profits**
 - Dividend income
- EXCESS treated as distribution from “pure” S corporation

PLANNING POINTERS

- Beware giving S corporation stock to key employees (**2% shareholder rule**)
- Pay **reasonable compensation** to shareholder-employees, then take the rest as distributions
- Make sure buy-sell agreement does not create second class of stock (use **straight debt safe harbor**)

