



# DOES THE “S” IN S CORPORATION STAND FOR “SUPERSCARY”?

**Geoffrey N. Taylor, Esq.**

## S Corporation Basics

- Pass-through treatment
- No tax at corporate level
- Shareholders generally not liable for debts of corporation
- Creation of federal tax law



# S Corporation Requirements

- Must be a domestic corporation
- No more than 100 shareholders
- Permitted shareholders
  - Individuals
  - Certain trusts - Grantor trusts, QSSTs, and ESBTs
  - Estates
- No prohibited shareholders

# S Corporation Requirements

- No ineligible corporations
- Single class of stock
  - Voting and nonvoting stock is permitted
- S corporation election
  - Late election relief may be available

# Termination of Election

- Termination events
  - Shareholder consent
  - Automatic termination for failure to meet requirements
  - Automatic termination for excess passive investment income



## Termination of Election

- Tax consequences
  - Election terminates as of revocation date
  - Tax year split into “S” and “C” portions
  - Income, gain, loss, deduction, and credit are generally allocated on a per share, per day basis
  - Corporation can also elect to close its books

## Termination of Election

- Relief
  - Was termination inadvertent?
  - Were steps taken to correct within a reasonable period of time?
  - Do shareholders agree to make any required adjustments?

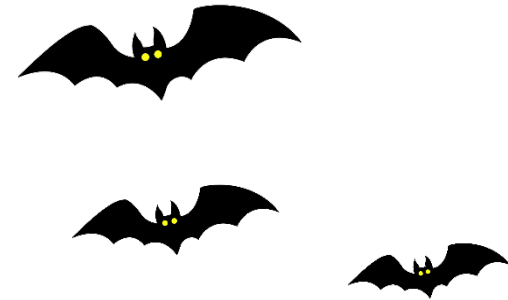
## Termination of Election

- No reelection for five years
- IRS can consent to earlier reelection if event causing termination
  - Not reasonably within control of corporation or shareholders having a substantial interest
  - Not part of plan to terminate



# Succession Planning

- Shareholder agreements
  - “Defensive S provisions”
  - Stock transfer restrictions
  - Mandatory or permissive buyouts
  - Mandatory tax distributions



# Succession Planning

- Gifts
  - Estate freezes
  - Income shifting
  - Young children and active vs inactive children
  - Use voting and nonvoting stock
  - Loss of step up in basis

## Post-Mortem Planning



- Be diligent if your client-shareholder passes away
- You have time to plan, but plan you must!

# Post-Mortem Planning

- You are OK if the stock is owned by estate or by a formerly revocable trust
- You must be aware of options (QSST and ESBT)
- You must be aware of the time limits
- Consider a 645 election

