

Filing as an S Corporation Can Help Avoid Double Taxation

If the business meets certain criteria, it may select this status

By Business Filings Incorporated

When deciding which entity structure is most appropriate for their business, small business owners often view the potential double taxation of profits associated with C corporations as the primary disadvantage to forming a standard corporation. With C corporations, the profits are taxed first at the corporate level, then taxed again at the individual level if they are distributed to shareholders (owners) in the form of dividends. Shareholders must report dividends as personal income and pay taxes on that income. The 2003 enactment of tax law changes by the Bush Administration will in many cases reduce the tax on dividends, but will not eliminate it.

Double taxation can be eliminated by completing the S corporation election with the Internal Revenue Service (IRS). S corporations are corporations that have elected a special tax status with the IRS. S corporations are taxed as pass-through taxation entities, similar to general partnerships and most limited liability companies. While the profits of an S corporation are reported at the corporate level, taxes are not paid at the corporate level. Instead, the profits are passed-through to the individual tax returns of the shareholders and are taxed at the individual rate. If the S corporation reports a loss, the amount of the loss is also passed-through and reported on tax returns of the shareholders.

Keep in mind, not all C corporations can make the S corporation election with the IRS, as the IRS has placed restrictions on S corporations. Current restrictions include:

- Shareholders must number fewer than 75, and all shareholders must consent in writing to the S corporation election.
- Shareholders must be individuals, estates, or certain qualified trusts.
- Shareholders cannot be non-resident aliens.
- S corporations can have only one class of stock (disregarding voting rights).

In order to elect S corporation status, the corporation must make a timely filing of Form 2553 with the IRS. For this election to take effect in the current calendar tax year, the election must be made by March 15, if the corporation is a calendar-year taxpayer. A corporation can decide later to elect S corporation status, but this election would not take effect until the following calendar year. For non-calendar year taxpayers, the election must be made by the 16th day of the 3rd month of the tax year for it to take effect in that tax year.

For questions on whether the S corporation structure is best for your particular business, it is best to seek the advice of an attorney or accountant.

About The Author

[Business Filings Incorporated](#) helps small business owners easily and affordably form corporations, limited liability companies (LLCs), and nonprofits in all 50 states without sacrificing quality. Beyond incorporation services, Business Filings provides EIN obtainment, S corporation election document preparation, corporate supplies, registered agent services in all states, and more.