

What Is An S Corporation?

Think of almost any major, public corporation. That corporation is almost certainly what is known as a C corporation.

A C corporation is taxed as a separate entity. When the corporation distributes dividends to shareholders, that income is subject to tax as well. This leads to double taxation.

One of the primary benefits of an S corporation is that its income is not taxed twice. An S corporation makes an election to be treated as a pass-through entity. In other words all corporate income is passed on to the owners, who pay tax on it. The corporation itself pays no tax on income (well, almost no tax. Please see below.)

There are certain restrictions on S corporations, as follows:

1. Must not have more than 100 shareholders
2. All the shareholders must consent to having the corporation treated as an S corporation
3. All the shareholders must be U.S. citizens
4. There can only be one class of stock; preferred stock is not allowed
5. The calendar must be used as the fiscal calendar. If some other fiscal year is desired, the IRS must be petitioned to allow it.

The election to be treated as an S corporation is made by filing Form 2553 with the IRS.

S corporations pay no federal income tax. They may however be liable for tax on certain capital gains and passive income.

Also, if the shareholder is working for the S corporation and there is a profit, the shareholder must be paid wages and the wages must be “reasonable compensation”. In other words, the amount you would have to pay someone else to do the job. If this is not done the IRS can re-classify the corporation’s profit as wages and make you liable for all the payroll taxes on those amounts.

An S corporation may have to file these tax forms with the IRS each year:

1. Income tax – form 1120S
2. Depreciation – form 4625
3. Estimated taxes – form 1120-W
4. Shareholders share information – form 1120S K-1

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5. Employment taxes – forms 941 and 940
6. Excise taxes – various

An S corporation shareholder may have to file these tax forms with the IRS each year:

1. Income tax – form 1040
2. Supplemental income and loss – Schedule E
3. Estimated tax - form 1040-ES
4. Self Employment tax – form 1040 SE
5. Others – as needed, for AMT, capital gains, etc.

This article is intended to be used as an introduction and a guideline. Seek professional assistance before making a decision about how to structure your small business.