TO ELECT, OR NOT TO ELECT, S-CORP TAXATION
THAT IS THE QUESTION

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State Bar of Texas Tax Section
Tax Law in a Day
February 7, 2020
Houston, Texas

DISCLAIMER

The author welcomes any corrections and suggestions for improvements to this outline

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Awards and Recognition

- Texas Super Lawyers Rising Star, Thompson Reuters, 2019, 2020
- Tax Leadership Academy, 2017

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I. INTRODUCTION

Entity taxation has long been an important driver in the selection of entity type for small business owners. Subchapter S of the Internal Revenue Code was originally passed into law in 1958 creating the "S Corporation". On December 22, 2017, the Tax Cuts and Jobs Act ("TCJA") was signed into law by President Donald J. Trump.[1] Among many changes to the tax code, the TCJA introduced two major changes to the tax law that will affect the choice of the election of S Corporation taxation for small businesses:

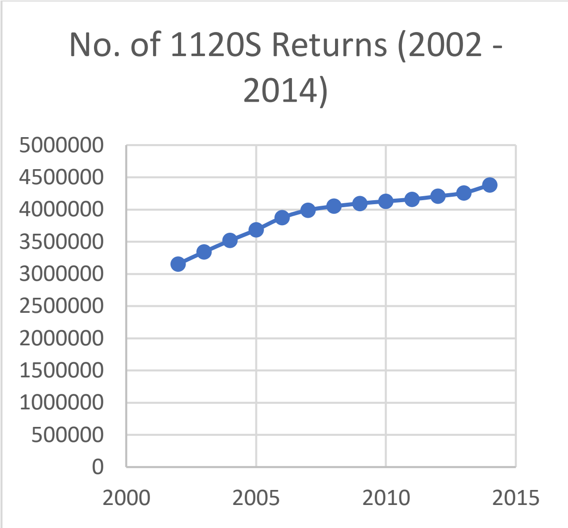
1) the TCJA permanently reduced the corporate tax rate from a maximum of 35% under a graduated tax rate structure to a flat 21%; and

2) the Qualified Business Income Deduction (199A).

The purpose of this paper is to reexamine the S Corporation election for small businesses considering the TCJA.

A. Business Owners Increasingly Elect S Corporation Taxation

IRS statistical data for S Corporations (2014, the last year available) shows that the number of S Corporations has steadily increased to a total of 4,380,125 1120s returns filed in 2014. Most S Corporations are small, averaging 1.65 shareholders and $115,694 net income.



B. The S-Corp Advantage?

1. Avoidance of double tax regime (compared to C corporations)

The primary benefit of S corporation taxation compared to C corporation taxation is the avoidance of the double tax regime. S Corporations are pass-through entities and therefore the earnings are only subject to one layer of taxation at the shareholder level. By comparison, C Corps are first taxed at the entity level (21% after TCJA went into effect). Earnings are again taxed when distributed to shareholders generally at 23.8%[2].

The following tables illustrate the effective tax results for the owners (making many assumptions). Prior to TCJA, the S Corporation tax advantage was much greater than it is today due to the reduction in the corporate tax rate from a maximum rate of 35% to a flat 21%. Now that the corporate tax rate has been reduced, the effect of the double tax regime is almost negligible for high earning taxpayers.

[1] An Act to Provide for Reconciliation Pursuant to Titles II and V of the Concurrent Resolution on the Budget for Fiscal Year 2018, Pub. L. No. 115-97, § 11061 (2017)

[2] IRC §1(h)(11) (20% highest marginal qualified dividend federal income tax rate) and IRC §1411(a) (3.8% Net Investment Income tax rate)

In the example below, prior to the TCJA, $49.53 was left to shareholders in an C Corporation and $56.60 in an S Corporation. After the TCJA, $60.20 remained for shareholders in a C Corporation and $59.20 in an S Corporation.

C Corporation (Prior to 2017 TCJA)

Taxable Income	$100.00
Corporate Rate	35%
Corp Tax Liability	$35.00
Cash Avail to Shareholders	$65.00
Individual Rate	20%
Net Investment Income Rate	3.80%
Individual Tax Liability	$15.47
Total Tax Liability	$50.47
Net to Shareholders	$49.53

C Corporation (After 2017 TCJA)

Taxable Income	$100.00
Corporate Rate	21%
Corp Tax Liability	$21.00
Cash Avail to Shareholders	$79.00
Individual Rate	20%
Net Investment Income Rate	3.80%
Individual Tax Liability	$18.80
Total Tax Liability	$39.80
Net to Shareholders	$60.20

S Corporation (Prior to 2017 TCJA)

Taxable Income	$100.00
Corporate Rate	0%
Corp Tax Liability	$0.00
Cash Avail to Shareholders	$100.00
Individual Rate	39.6%
Net Investment Income Rate	3.80%
Individual Tax Liability	$43.40
Total Tax Liability	$43.40
Net to Shareholders	$56.60

S Corporation (After 2017 TCJA)

Taxable Income	$100.00
Corporate Rate	0%
Corp Tax Liability	$0.00
Cash Avail to Shareholders	$100.00
Individual Rate	37.0%
Net Investment Income Rate	3.80%
Individual Tax Liability	$40.80
Total Tax Liability	$40.80
Net to Shareholders	$59.20

2. <u>Flow-through of Corporate Losses to Owners (compared to C corporations)</u>

A second major reason that owners may prefer to elect S Corporation taxation over C Corporation taxation is the ability to pass losses through to owners of the business, subject to the following:

(a) the ability to pass such losses through to the owners is limited by a) stock and debt basis limitations, b) at risk limitations, and c) passive activity loss limitations; and

(b) the TCJA placed a limitation on the ability of offsetting income with excess business losses if the amount of the loss is in excess of $250,000 for individual taxpayers ($500,000 for joint returns).[3]

Net losses incurred by C Corporations are deducted from corporate income; they do not pass through to the shareholders.

3. Potential self employment tax reduction (compared to partnerships)

S Corporations may provide a tax advantage over partnerships by reducing self-employment tax. In a partnership, partners are subject to self-employment tax on earnings generated from active involvement in the business. Limited partners in a limited partnership may exclude self-employment tax but general partners are subject to self-employment tax on their distributive share of the income.[4] Courts have generally imposed self-employment tax on all members of limited liability companies unless they lack management authority and don't provide significant services to the business.[5]

With an S Corporation, however, shareholders that actively participate in the business take and pay self-employment tax on a salary. Distributions in excess of the salary are treated as passive income and are not subject to self-employment tax. The salary must be "reasonable" as defined in numerous IRS revenue rules and tax court cases.[6]

The following illustrates a very simplified example of a married couple with earnings of $300,000 and a salary of $100,000. The federal income tax liability is the same for the S Corporation and the partnership, but the S Corporation results in over $10,000 in self-employment tax savings.

S Corporation (After 2017 TCJA)

Earnings	$200,000.00
Salary	$100,000.00
Standard Deduction	$24,800.00
Taxable Income	$275,200.00
Effective Individual Rate	20.0%
Individual Tax Liability	$55,040.00
Self Employment Tax	
Social Security (12.4% to $137,700)	$12,400.00
Medicare tax (2.9%)	$2,900.00
Total Tax Liability	$70,340.00
Net to Owners	$229,660.00

Partnership (After 2017 TCJA)

Earnings	$300,000.00
Salary	$0.00
Standard Deduction	$24,800.00
Taxable Income	$275,200.00
Individual Rate	20.0%
Individual Tax Liability	$55,040.00
Self Employment Tax	
Social Security (12.4% to $137,700)	$17,074.80
Medicare tax (2.9%)	$8,700.00
Total Tax Liability	$80,814.80
Net to Owners	$219,185.20

[3] TCJA amended IRC § 641(I).

[4] IRC § 1402(a)(13).

[5] Proposed Regs. Sec. 1.1402(a)-2.

[6] Guidance from the IRS provided at https://www.irs.gov/businesses/small-businesses-self-employed/paying-yourself

4. Eligibility for the Qualified Business Income Deduction

The TCJA added Section 199A, also known as the Qualified Business Income deduction.[7] Section 199A provides a potential pass-through deduction equal to 20% on allocable "qualified business income".

The relevant portion of 199A[8] is as follows:

> (2) DETERMINATION OF DEDUCTIBLE AMOUNT FOR EACH TRADE OR BUSINESS. The amount determined under this paragraph with respect to any qualified trade or business is the lesser of-
>
> (A) 20 percent of the taxpayer's qualified business income with respect to the qualified trade or business, or
>
> (B) the greater of-
>
> (i) 50 percent of the W-2 wages with respect to the qualified trade or business, or
>
> (ii) the sum of 25 percent of the W-2 wages with respect to the qualified trade or business, plus 2.5 percent of the unadjusted basis immediately after acquisition of all qualified property.

Many articles have been written in detail about Section 199A, so this paper will focus on several important aspects of Section 199A as they relate to the choice of S Corporation taxation:

(a) No C Corporations. Section 199A does not apply to C corporations.

(b) Specified Trades or Businesses. Section 199A does not apply to businesses that are not a "qualified trade or business"[9], which includes doctors, lawyers, accountants, and others. Many of the businesses that would potentially benefit from S Corporation taxation to reduce self-employment tax do not qualify for the 199A deduction. For these types of businesses, the decision to elect S Corporation taxation does not depend on the 199A deduction.

(c) Sole Proprietorships. Sole proprietorships and entities taxed as sole proprietorships such as single member limited liability companies (i.e. disregarded entities) do not have employees and cannot pay the owner W-2 wages. Because they do not pay W-2 wages, the 199A deduction is calculated as $0. By converting to S corporation taxation, the owner may now take a W-2 wage and may have a 199A deduction.

The graph below shows a business owner's total tax liability in a very simplified tax scenario of a married taxpayer with $300,000 in earnings from a sole proprietorship; many assumptions have been made. As can be seen in the graph, the owner's tax liability is reduced significantly if S Corporation taxation is elected compared to partnership taxation.

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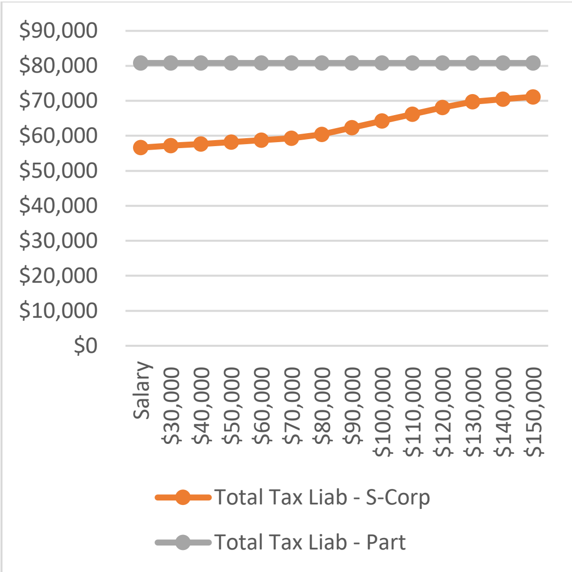
[7] IRC § 199A.

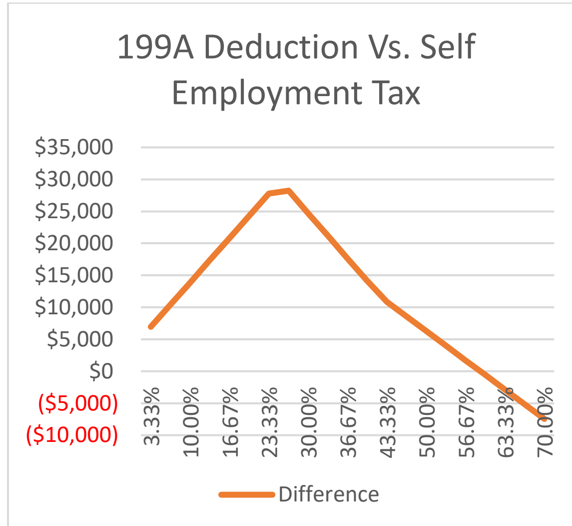
[8] IRC § 199A(b)(2).

[9] IRC § 199A(d).



(d) Tradeoff: 199A Deduction Vs. Self-Employment Tax. To get the greatest reduction in self-employment tax, the business owner is encouraged to reduce his salary to the lowest reasonable salary possible. However, this conflicts with Section 199A, where the deduction amount in part depends on increasing W-2 wages, at least up to the point where 50% of such wages equals 20% of the taxpayer's qualified business income. In other words, the effort to reduce self-employment tax may also reduce the amount of possible 199A tax deduction.

The graph below shows the difference between the 199A deduction and the self-employment tax incurred for a very simplified tax scenario for a married taxpayer with $300,000 in earnings where the business has elected S Corporation taxation and the owner is taking a salary. The x axis represents the ratio of salary to earnings and the y axis represents the difference between the 199A deduction and self-employment tax. As can be seen in the graph, in this scenario the optimal salary vs. earnings percentage is about 27-28%.



I. S-CORP BASICS

A. S-Corporation Defined: 26 US Code Section 1361

Internal Revenue Code Section 1361(a) defines an S Corporation as "a small business corporation for which an election under section 1362(a) is in effect for such year."[10]

Section 1361(b)(1) further defines the term "small business corporation" which does not

(a) have more than 100 shareholders,

(b) have as a shareholder a person who is not an individual, [11]

(c) have a nonresident alien as a shareholder, and[12]

(d) have more than 1 class of stock.

[10] IRC § 1361(a)

[11] LLCs treated as disregarded entities also are eligible shareholders's. See IRS Letter Rulings 9745017, 200107025, 200303032, and 200513001.

[12] TCJA Update: nonresident alien may be a potential current beneficiary of an electing small business trust (ESBT) and the ESBT will not become a disqualified SH. (Tax Cuts and Jobs Act (TCJA), P.L. 115-97)

Furthermore, certain corporations are ineligible to make S elections, including:[13]

(a) foreign corporations

(b) financial institutions which use the reserve method of accounting for bad debts

(c) certain insurance companies,

(d) current or former domestic international sales corporations, and

(e) former S Corporations who have terminated their S-election within the prior five years.

B. S-Corp Election, Revocation, and Termination: 26 U.S. Code § 1362

1. <u>How to elect.</u>

Entities must expressly elect to be taxed as an S Corporation by filing IRS form 2553.[14] All shareholders must consent to the S Corporation election.[15]

2. <u>When to elect.</u>

An S Corporation election may be made by a small business corporation for any taxable year

(a) at any time during the preceding taxable year, or

(b) at any time during the taxable year and on or before the 15th day of the 3rd month of the taxable year.[16]

However, a late election may be treated as timely under certain circumstances if the IRS determines there was reasonable cause for the failure to timely make such election.[17]

The IRS has also provided late election relief under Rev. Proc. 2013-30. S Corporation elections can be made up to 3 years and 75 days after the date for which the S election is intended to be effective. The election form must state at the top of the document "FILED PURSUANT TO REV. PROC. 2013-30." After the late election relief period has passed, taxpayers can also pursue a private letter ruling.[18]

3. <u>Termination.</u>

An S Corporation election may be terminated voluntarily by revocation or involuntarily. For voluntary terminations, more than half of shares must consent to revocation.[19] As a consequence of voluntary termination, the small business is not eligible to re-elect S Corporation taxation for 5 years after the year the termination is effective.[20]

An S Corporation election may also involuntarily terminate if the entity ceases to qualify as a small business corporation, for example, if the entity has more than 100 shareholders, a shareholder is not eligible to be a shareholder in an S Corporation, or if the S Corporation has more than one class of stock.[21]

III. REASONS TO NOT ELECT S CORPORATION TAXATION

Despite certain advantages of S Corporation taxation, there are many scenarios where an S

[13] IRC § 1361(b)(2)

[14] See https://www.irs.gov/forms-pubs/about-form-2553

[15] IRC § 1362(a)(2)

[16] IRC § 1362(b)(1)

[17] IRC § 1362(b)(5)

[18] Rev. Proc. 2019-1

[19] IRC § 1362(d)(1)

[20] IRC § 1362(g)

[21] IRC § 1362(d)(2)

Corporation election would be inappropriate or detrimental to the taxpayer.

A. What are the client's plans for the future? Does the client plan to exit the business at some point?

1. S-Corp restrictions may discourage potential buyers (i.e. VC firms)

By electing S Corporation taxation, the business may be less attractive as an acquisition target. First, the ownership structure of many venture capital firms may cause an automatic termination of S Corporation status. Many VC's have owners that are themselves partnerships or they may have foreign owners, both which are not eligible owners of an S Corporation.

Second, the ownership of many VC firms (i.e. foreign ownership, greater than 100 owners, etc.) may make structuring an acquisition difficult. For example, the S Corporation requirements may make a stock purchase of an S Corporation difficult to structure. Therefore, an acquirer may be forced to structure the acquisition as an asset purchase (rather than a stock purchase) or the acquirer may purposely terminate the S Corporation status.

Finally, many VC's simply may not want to deal with the complexity of pass through taxation for its owners.

2. Do they want to grow the company to have more than 100 shareholders?

The S Corporation election may place limits on growth of the company. For example, the S Corporation limitation of 100 shareholders can be reached faster than the owners might expect, especially if the owner wants to offer stock as an employee incentive.

Furthermore, problems can arise if the company has already reached the 100 shareholder limit but still needs to raise capital. The company would not be able to bring in new shareholders without terminating the S Corporation status.

3. Restriction to one class of stock.

Potential investors often require preferred returns or separate classes of stock. For example, such investors may require shares that have a preferred return within a distribution waterfall or shares that have preferential voting rights over other shares. The S Corporation restriction to one class of shares does not allow for preferential treatment of some shareholders over other shareholders.

4. Section 1202 deduction only available for C Corporations

Under IRC Section 1202, the gain on the sale of "Qualified Small Business Stock" held for five years or more may be partially or entirely excluded from income.[22] "Qualified Small Business Stock"[23] is defined as any stock in a C Corporation what when originally issued the corporation was a qualified small business.

Section 1202 simply is not available for partnerships and S Corporations. If the owner is thinking about exiting the business in 5-10 years and the business qualifies under Section 1202, the owner should carefully consider whether the potential interim tax reduction provided by S Corporation taxation outweighs the gain exclusion under 1202.

Furthermore, a taxpayer cannot convert from a S Corporation to a C Corporation and have access to Section 1202. The issuing corporation must be a C Corporation at the time of issuance of the stock. That said, the S Corporation converted to a C Corporation can issue new shares for new consideration after the conversion. The new shares may qualify for Section 1202 if at the time

[22] IRC § 1202.

[23] IRC § 1202(c).

of issuance the company is still a qualified small business.

B. Will the client have foreign ownership, now or in the future?

A corporation having a nonresident alien does not qualify as a small business corporation. A nonresident alien is an individual that has not been legally admitted for permanent residence and has not met the substantial presence test.[24] If the entity has nonresident alien shareholders, or may have them in the future, it simply does not qualify for the S Corporation election. Therefore, partnership or corporate taxation must be chosen.

C. Is the intent to reinvest most / all of the funds back in the business?

If the business owner intends to reinvest earnings back in the business, a C Corporation may be a better choice than an S Corporation. With the reduction in the corporate tax rate to 21% under the TCJA, a taxpayer may invest a greater portion of funds in the business as a C Corporation compared to a pass-through entity. The C Corporation advantage is especially important for wealthy taxpayers subject to high marginal tax rates. Additionally, this benefit increases as the growth rate and holding period on the reinvested funds increases.[25]

The following table is a simple example showing this effect. On \$100 in earnings, \$79 may be reinvested back in the company in a C Corporation whereas only \$59 is available to reinvest in an S Corporation.

[24] IRC § 7701(b)(1)(B).

[25] The ability to stockpile assets in the C-corp is limited to the accumulated earnings tax (Section 531). Safe harbor of \$250k (Section 532(c)(2)) unless there are provable business needs.

C Corporation (After 2017 TCJA)

Taxable Income	\$100.00
Corporate Rate	21%
Corp Tax Liability	\$21.00
Cash Avail to Reinvest	\$79.00

S Corporation (After 2017 TCJA)

Taxable Income	\$100.00
Corporate Rate	0%
Corp Tax Liability	\$0.00
Cash Avail to Shareholders	\$100.00
Individual Rate	37.0%
Net Investment Income Rate	3.80%
Individual Tax Liability	\$40.80
Total Tax Liability	\$40.80
Cash Avail to Reinvest	\$59.20

D. Will the client own real estate or other appreciating assets?

Like C Corporations, S Corporation are subject to tax on certain built-in-gains.[26] Built-in-gains (“BIG”) are defined as the difference between the fair market value of the S Corporation assets and the aggregate adjusted basis of such assets at that time. BIGs are recognized on the sale or disposition of an asset.

For any tax year in which there is a BIG, there is an additional tax imposed by applying the highest marginal tax rate (currently 21% due to TCJA) to the BIG. Although the taxpayer never wants to

[26] IRC § 1374.

incur the BIG tax, prior to the reduction in the corporate tax rate due to the TCJA the taxpayer would incur BIG tax at a much higher rate.

The imposition of the BIG tax is limited in the following ways:

1) The BIG tax only applies to asset dispositions during the first 5-year period after the effective date of the S Corporation tax election[27];

2) The BIG tax does not apply to any corporation which has always been taxed as an S Corporation[28];

3) The BIG tax is also limited to income tax that would have been incurred as a C-Corporation. Therefore, a taxpayer can avoid the BIG tax if the entity has no taxable income for the first 5 years.

Because of the BIG tax, it is generally detrimental to hold appreciating assets (or assets that are subject to depreciation) in a S Corporation, especially if the owner intends to dispose of the assets within the 5 year recognition period (i.e. selling the assets, distributing the assets in-kind to the shareholder, gifting the property to a child, etc.). Under partnership taxation, on the other hand, there is no immediate tax impact of distributing the property from the partnership.

Note that a real estate "flipper" is less effected by the BIG tax because they do not intend to buy and hold the property for a long period of time. Additionally, property developers are subject to both ordinary income tax and self employment tax on the proceeds of a real estate sale.

E. Will the client's earnings outweigh the costs of maintaining the S-election?

From a practical standpoint, the taxpayer will incur additional costs to maintain an entity with an S Corporation election. For example, the taxpayer will be required to run payroll to pay salaries from the S Corporation. Typical costs for online payroll software costs approximately $25-200 per month. Additionally, the S Corporation will also require an 1120s tax return each year. According to the 2016-17 NSA Income and Fees of Accountants and Tax Preparers in Public Practice Survey Report, the average cost of an 1120s tax return was $809.

Although the S Corporation election can result in a significant reduction in self-employment tax, the costs of maintaining the must be considered when deciding if the tax savings outweighs the additional costs, especially for disregarded entities that do not require payroll or a federal income tax return.

F. Is the client a high income investor?

High income passive investors in the highest tax brackets will not see significant benefits from pass-through S Corporation taxation, especially if the businesses do not qualify for the 20% deduction. In 2020 the highest individual marginal tax rate is 37% (which will revert back to 39.6% in 2026). In a C Corporation, however, the investor would incur an effective tax rate of 39.8% (21% at the corporation level + 23.8% for dividends*79%). Note that an active investor receiving W-2 wages will potentially see a self-employment tax reduction in a S Corporation compared to partnership taxation.

G. Will the client want to make disproportionate distributions to certain Shareholders? Disproportionate allocations of profits and losses?

S Corporations cannot disproportionately allocate profit among the shareholders. Distributions of

[27] IRC § 1374(d)(7).

[28] IRC § 1374(c)(1).

profit must be proportionate according to the shareholder's ownership in the entity.

The proportionate distribution rule is based on the requirement of one class of stock[29]. Tax regulations provide that "a corporation is treated as having only one class of stock if all outstanding shares of stock of the corporation confer identical rights to distribution and liquidation proceeds." Therefore, an S Corporation cannot have disproportionate distributions because that would imply more than one class of stock.

Deemed disproportionate distributions can result in inadvertent termination of S-Corp status. Limited liability companies and limited partnerships that elect S Corporation taxation should evaluate partner's rights carefully within the partnership agreement to determine if multiple classes of stock are created inadvertently (for example, liquidating distributions based on capital accounts rather than ownership of units).

Partnerships can make disproportionate distribution without any issues. Partners may desire to distribute profit disproportionately for a variety of practical reasons, such as when one partner contributes more to the partnership than other partners of equal ownership.

H. Does the client want to offer different retirement benefits to select employees?

Contributions must be the same to all eligible employees of the S Corporation retirement plan. A shareholder cannot make a large contribution to their retirement plan without making the same contribution to the retirement plans for all eligible employees. For example, the owner / physician in a doctor's office may desire to make a large contribution to their SEP IRA. If the entity is taxed as an S Corporation, they would also have to make the same proportionate distribution to the staff employed by the entity.

I. Will the client use the stock of the company for estate planning purposes?

From an estate planning standpoint, S Corporations are not ideal. First, the single class of stock requirement makes succession planning more difficult. Parents often transfer ownership in the family business by making gifts or sales of stock to their children. The requirement of one class of stock limits the options that are available to the parent passing S Corporation stock ownership to their children. Notwithstanding the single class of stock rule, IRS Regulations do provide that the entity can issue voting and non-voting stock, which if identical in all other respects, including distributions and liquidations, will not be treated as different classes of stock within the meaning of § 1361(b)(1)(D).[30]

Second, only certain kinds of trusts can hold S Corporation stock such as grantor trusts, qualified revocable trusts, qualified subchapter S trusts (QSST)[31] and electing small business trusts (ESBT)[32]. Grantor trusts become non-grantor trusts (and therefore ineligible S Corporation shareholders) upon the death of the grantor. In this case, the grantor trust can only hold S Corporation shares for at most 2 years after the date of death of the deceased grantor.[33] Similarly, a testamentary trust created by a Last Will and Testament can hold S Corporation stock for at most 2 years after the date in which the shares were transferred to such trust.[34]

These limitations make it difficult to implement complicated estate planning techniques used by

[29] Section 1.1361-1(l)(1) of the Income Tax Regulations

[30] IRC § 1361(b)(1)(D) and Section 1.1361-1(l)(1) of the Income Tax Regulations.

[31] IRC § 1361(d)(1).

[32] IRC § 1361(c)(2)(A)(v).

[33] IRC § 1361(c)(2)(A)(ii).

[34] IRC § 1361(c)(2)(A)(iii).

parents to transfer their business to their children and maintain the S Corporation election.

J. Fringe benefits

Businesses often use fringe benefits to compensate employees. In general, fringe benefits are taxable income to the employee, with the exception of certain fringe benefits.[35] Excludable fringe benefits include, among others, the cost of group-term life insurance, amounts paid for or to an accident or health plan, health savings accounts, and meals and lodgings furnished for convenience of the employer.

In general, certain fringe benefits provided by a S Corporation are not taxable to employees. However, employees that own 2% or greater of a company are treated like partners in a partnership for the purposes of determining taxability on fringe benefits, rather than employees[36]. In these cases, most fringe benefits are taxable to the employee, including premium payments for employee owned life insurance, health insurance premiums, accident insurance premiums, disability insurance premiums, long-term care insurance premiums, personal use of a company car, lodging, and meals. For employees that own 2% or greater of the company shares, such fringe benefits are recognized as wages and included in the employee's W-2 wages, subject to regular federal withholding and employment tax withholding. Furthermore, if the S Corporation fails to properly report such fringe benefits as compensation, the IRS may determine that unequal distributions have been made to such shareholder (violating the single class rule), potentially terminating the S Corporation election.

IV. CONCLUSION

With the high C Corporation tax rates prior to the TCJA, the benefits of pass through taxation and a reduction in self-employment tax made the election of S Corporation taxation very attractive in many cases. However, given the new corporate tax rate of 21% and the 199A tax deduction, the analysis has become more complex as to determine advisability of the S Corporation election. Furthermore, other factors such as treatment of fringe benefits, retirement planning, estate planning, and the short and long-term goals of the business owner can become important in the S Corporation decision.

Politics must also be considered in the decision to elect S Corporation taxation. With the presidential election in 2020 and congressional election in 2022, a dramatic shift in tax policy could affect tax planning and strategy. Because S Corporation elections cannot be resubmitted for 5 years after revocation, a business owner could be stuck with a bad choice until the 5-year term runs. Most of the provisions of TCJA are set to automatically expire after 2025, which will again alter the analysis. The 21% corporate tax rate is permanent, but even that could change if the elections result a change in power in Washington.

Given this uncertainty, is it wise to make significant structural tax changes? Perhaps the best approach is to use multiple entities to segregate business units to optimize overall taxation for the client.

[35] IRC § 132.

[36] IRC § 1372