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## SHOULD YOU ELECT S STATUS FOR YOUR CORPORATION?

By Victor Sy, CPA, MBA

Some of you have probably heard and read of S corporations. Some of you probably even have elected S status for your own corporations. Let us revisit this tax-saving vehicle that should be used, or at least considered, by realtors, lawyers, doctors, accountants, and other personal service entities.

The letter "S" comes from Subchapter S of the Internal Revenue Code. It was added to the code in 1958, then amended in 1982 and 1986.

Electing S status for your corporation gives you the best of both worlds: the liability protection of a corporation and no double taxation of a sole proprietorship. In other words, an S corporation does not pay Federal income tax and very little franchise tax.

First, let us review the [advantages of an S corporation](#):

1. As previously mentioned, it does not pay Federal income taxes. It only pays a minimal 1.5% State franchise tax (as opposed to 8.84% for a regular corporation). The tax savings can be enormous because the double taxation in C corporations can reach a high of 67% in Federal and State income and payroll taxes – especially for personal service corporations (doctors, lawyers, accountants) which are taxed at flat federal rate of 35%.
2. Charitable contributions can be passed through to individual shareholders who enjoy a maximum deduction of 50% of adjusted gross income (as opposed to only 10% for regular C corporations).
3. Passive income from an S corporation can be used to offset individual passive losses that would otherwise be unused and suspended.
4. S corporations are not subject to accumulated earnings tax and alternative minimum tax.
5. Unlike sole proprietorships and partnerships, net earnings from S corporations are not subject to self-employment tax.

Next, let us discuss the [disadvantages of an S corporation](#):

1. S corporations are generally required to use calendar years (December 31). This limits the opportunity to shift income from one year to the other.
2. Fringe benefits received by a 2% shareholder are not excludable from income. This includes \$50,000 of group term life insurance, \$5,000 death benefit, and meals and lodging for the convenience of the employer.
3. A 6% or more shareholder is not allowed to borrow money from a qualified retirement plan. Such borrowing is a prohibited transaction that could result into penalties and plan disqualification.

As you can see, an S corporation has more advantages than drawbacks and should be considered as an alternative in your tax planning sessions with your accountant.