

## **S Corporation Vs C Corporation Advantages & Disadvantages**

An S-corporation could be considered a hybrid of a C-corporation and a partnership. The S corporation retains the legal status of a corporation while providing for the direct pass-through of income and loss to the shareholders (similar to a partnership). Although similar to both a C-corporation and a partnership, the S-corporation has a unique set of rules.

### Advantages of the S-corporation over the C-corporation

- 1 Taxed at individual shareholder's level rather than Federal Corporate tax level.
- 2 Avoid double taxation. Dividends are not taxed if the S-corporation was organized after 1982.
- 3 Distribution of earnings are not subject to self-employment tax. However, shareholder-employees must receive a reasonable wage.
- 4 Losses are passed through and deductible by shareholders. This may be especially significant in the beginning years of business when many businesses experience a loss.

### Disadvantage of an S corporation

1. Fringe benefits - Certain fringe benefits are not deductible for 2% or more owners of an S corporation.
2. An S corporation may only have one class of stock. This could discourage investment by those who want preferred stock.
3. S Corporation Restrictions - The number of shareholders is limited, shareholders cannot be nonresident aliens, the corporation must be a domestic corporation and shareholders must be individuals.
4. S Corporation must not have more than 100 shareholders.
5. Retirement plan loans to shareholders may be limited.

6. Certain qualify C corporation may have half the gain in the sale of the original issued shares tax free if held for a qualifying period. S corporations do not have this tax advantage on the sale of their stock, although this advantage for C-Corporations is minimized by the 15% capital gains tax.

The corporation must first be formed before the S election is made. The S corporation status is elective. The corporation must make an election to be an S corporation or the C corporation rules automatically apply.

In general, if you plan on operating a relatively small corporation (under \$1 million in sales), do not plan on issuing shares to more than 35 shareholders or have equity financing, and do not plan on selling the shares in the near future, than an S corporation is usually in order. The S and C corporation decision should be made after consultation with your accountant.

**The above is for informational purposes only. Any decision to be made or action to be taken based on the above should be more fully evaluated by a qualified advisor.**