

### **SEATA Presentation**

# **S** Corporations Formation and Termination



# IRC §1361(a)(1)

Defines an "S corporation", with respect to any taxable year, as a small business corporation for which an election under IRC §1362(a) is in effect.



IRC §1361(b)(1) defines a Small Business Corporation as –

- a domestic corporation ,
- which is not an ineligible corporation,





#### Does not have:

- as a shareholder a person who is not an individual (other than an estate, a trust described in subsection (c)(2), or an organization described in subsection (c)(6)),
- a nonresident alien as a shareholder,
- more than 100 shareholders,
- more than 1 class of stock.



# **S Corporation Requirements**

- Domestic Corporation
- Allowable Shareholders
- No More Than 100 Shareholders
- One Class of Stock
- Not an Ineligible Corporation



- Individuals who are U.S. citizens or resident aliens,
- Estates,
- Certain domestic trusts,
- Pension plans under IRC §401(a) (including ESOPs), or
- IRC §501(c)(3) charitable organizations.





During the preceding year or the current year - within 2 months and 15 days after tax year begins.

A new corporation's tax year begins the earliest of when the corporation:

- Issues shares,
- Acquires property, or
- Commences business.



# **S Corporation Election**

#### Election to be effective:

- Corporation must meet ALL eligibility requirements on each day of the election year, including the pre-election period,
- Corporation must meet eligibility requirements on the day the election is filed if filed in the year preceding the election year, and
- ALL shareholders must consent.

# Elections in Addition to Form 2553

- QSST Beneficiary files election statement. IRC §1361(d)(2) and Treas. Reg. §1.1361-1(j)(6)(iii).
- ESBT Trustee files election statement. Treas. Reg. §1.1361-1(m)(2)(iii).
- QSub Corporation files Qualified Subchapter S Subsidiary Election, Form 8869. Treas. Reg. §1.1361-3.
- LLC Files Form 8832, Entity Classification Election, to be taxed as a corporation.

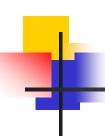


# Calendar Year Exceptions

Small Business Corporation, must have election in effect and a permitted tax year.

#### Calendar Year Unless

- > 50% of shareholders have the same fiscal year as the corporation,
- Natural business year exception,
- Business purpose exception, or
- Tax deposit is made with IRC §444 Election (Year ending September, October or November).

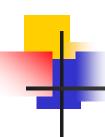


### Relief for Late Elections

- Revenue Procedure 2003-43
  - Entity fails to file the appropriate election timely
  - Attach statement to Form 2553 to request relief
  - Must be filed within 24 months of the due date of the election

# S Corp return filed – No valid election

- If no valid election on file, the service center cannot process the Form 1120S
- Service Center sends letter to taxpayer
  - Taxpayer can respond and ratify the election via Rev. Proc 2007-62 (if within 6 months of due date of return)
  - If no response, service center converts return to C Corp and assesses tax at corporate level; but no adjustments are made by service center at the shareholder level



### Relief for Late Elections

- Revenue Procedure 2007-62
  - Allows election to be made on the first filed Form 1120S
  - Must be filed within 6 months of due date of tax return (i.e. 9/15 for 3/15 due date)
  - Request relief on Form 2553 (Part 1, Line H)



### **Inadvertent Invalid S Elections**

### IRC 1362(f)

- Granted by National Office (service center cannot grant this relief)
- Request Private Ruling for relief (procedures in Rev. Proc 2009-1)
  - Too many shareholders
  - Invalid shareholder, etc.



### **Terminations**

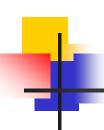
# Election terminated when the corporation:

- 1. Voluntarily revokes the election, or
- 2. Involuntarily by the corporation ceasing to be a small business corporation, or
- 3. When passive investment income exceeds 25% of gross receipt for 3 consecutive years AND the corporation has accumulated earnings and profits.



# **Effect of Mid-Year Termination**

- Corporation files 2 short period returns,
  - Short S Year and Short C Year
- All income and deductions are split:
  - Pro-rata allocation method, or
  - Interim closing method (IRC 1377(a)(2))
- Both (S corporation and C corporation) returns are due on the "corporate" due date, and
- C corporation tax determined on an annualized basis.



### **Allocation of Items**

- No change in ownership:
  - Based on percentage of ownership.
- Change in ownership:
  - Per-share per-day allocation method, or
  - Interim closing of the books method (if elected).

# Per Day Allocation

- Equal amount of items to each day.
  - determine all amounts (income, loss, deduction, or credit) for entire year then allocate throughout the year on a daily basis
  - Termination on February 22; then allocation to short S Year is
    52 days/365 days X Total income for entire year; remainder is reported on short C Year return.
- Change in ownership pro rata share.

% shares owned X % year owned = Overall % Owned x Taxable Income/Loss Item = Amount Reported



### **Interim Closing of the Books**

- Election must be filed with return,
- All affected parties must consent,
- Divide year into two short taxable years (both returns due on 3/15)
  - S Termination short year ends on day prior to termination event
  - C Corporation short year begins day of termination event and ends 12/31 19