

**From the desk of
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Forming an S Corporation

There are a number of different forms to do business under, one of them being an S corporation which is the same as a regular C corporation but with special income tax treatment.

Both an "S" corporation and a "C" corporation derive their names from the respective Internal Revenue Code (IRC) subchapters from which describes and dictates how a corporate entity is to be taxed.

A "C" corporation being from IRC subchapter C, whereas an S corporation derives the designation from IRC subchapter S.

Both entities provide liability protection but an S corporation allows profits or losses to pass through to the shareholders personal tax returns with specific rules and regulations spelled out in Subchapter S of the IRC.

To obtain an S status the shareholders must elect on Internal Revenue Service (IRS) form 2553 within 75 days of the beginning of the initial tax year of business, or within the same period of the first year a C corporation is to be converted to an S status.

Theoretically an S status prevents the double taxation scenario created under a C corporation.

A major area of contention between owners of S corporations and the IRS is that many fail to pay themselves a reasonable corporate salary believing that they can distribute all earnings to themselves without paying wages thereby bypassing all payroll taxes.

This is an immediate road to disaster as this approach will trigger an audit where the IRS will in fact then determine what the salary should have been, not a good scenario.

We always suggest something reasonable, and generally depending upon profits, some amount up to the annual Social Security wage limit which for 2017 is \$127,200.00.

Thereafter depending upon the nature of the business, how many employees, and what services the offices/shareholders perform the balance of any profits can be paid as a dividend, which is distributed free of employment taxes.

The IRS can and will determine reasonable officer/shareholder salaries based upon similar industries, and the services performed by the officer/shareholder.

The IRS is well aware that many owners of S corporations are tempted to underreport salary to avoid paying payroll taxes while distributing payroll-tax-free dividend.

An alternate form of business which does not necessarily face this same problem is an LLC which the IRS has yet to enforce the same criteria as to wages in that an LLC can elect to be formed under the partnership rules of the Internal Revenue Code.

Wages for partners are ironically not required, and therefore not subject to payroll taxes.

An LLC operating under the partnership rules still affords corporate protection to the owners of the entity.

Forming an S corporation is the same as the steps for setting up a regular corporation with the additional step of electing S status with the IRS.

To qualify for S corporation status, certain rules apply, such as having fewer than one hundred shareholders and issuing only one class of stock.

Our emphasis at Muffoletto & Company is to provide you the proper guidance and understanding of the system so that you avoid taxes to the extent that the law allows.

Should you have questions relating to these matters, tax, financial, and accounting issues,

give us a call at

(818) 346-2160.

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