

A Message from Michael

Tax Solutions for S Corporations

An S corporation is a pass-through entity that is treated like a partnership for federal income tax purposes. As a result, all income is passed through to the shareholders and taxed at their individual tax rates. However, an S corporation's income is taxable to the shareholders when it is earned whether or not the corporation distributes the income. Because this unique tax structure directly impacts shareholders, it is important to understand the S corporation distribution and loss limitations, as well as how and when items of income and expense are taxed.

Some S corporation income and expense items are subject to special rules and separate identification for tax purposes. Examples of separately stated items that could affect a shareholder's tax liability include charitable contributions, capital gains, Sec. 179 expense deductions, foreign tax, and net income or loss related to rental real estate activities.

These items, as well as income and losses, are passed through to the shareholder on a pro-rata basis, which means that the amount passed through to each shareholder is dependent upon that shareholder's stock ownership percentage. However, a shareholder's portion of the losses and deductions may only be used to offset income from other sources to the extent that the total does not exceed the basis of the shareholder's stock and the basis of any debt owed to the shareholder by the corporation. The S corporation losses and deductions are also subject to the passive activity rules.

Please don't hesitate to call us if we can assist you with identifying and maximizing potential tax savings.

All the best,



Michael Resnick
Tax Practice Group
Batchelor, Frechette, McCrory, Michael & Co.

THINGS TO KNOW

- Shareholders in an S corporation are required to take a reasonable salary, otherwise distributions could be re-classed as salary under an IRS examination.
- When taking losses from an S corporation at the shareholder level, shareholders must consider passive activity rules. A shareholder who does not materially participate in an S corporation may be limited to taking a deduction only to the extent of passive income.
- Without retroactive reinstatement to January 1, 2014, the section 179 expensing limitation decreases from \$500,000 to \$25,000 and the 179 phase out limitation decreases from \$2,000,000 of asset purchases to \$200,000. S corporations need to take this potential reduction into consideration.



**Lisa Fowler with Mark DePasquale
and Steve DePasquale from
Green Development**



*40 Westminster Street, Suite 600
Providence, RI 02903*

Michael S. Resnick

Telephone: (800) 417-3280 x3023

E-mail: mresnick@bfmmcpa.com

Other key points to consider when developing your comprehensive tax strategy:

- » The availability of the Code Sec. 179 deduction at the corporate and shareholder level
- » Reporting requirements for the domestic production activities deduction
- » The tax treatment of fringe benefits
- » Below-market loans between shareholders and S corporations
- » IRS scrutiny of distributions to shareholders who have not received compensation

Return Service Requested