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TAX PRACTICE GROUP WINTER 2014

A Message from the Tax Practice Group

S corporation (S) or C corporation (C): A Fresh Look

A fundamental rule of tax has been if you are a closely held corporation, the entity of choice is an S. With C tax rates now below the top individual tax rate, small business owners are asking if now is the time to switch to C.

Primary advantages of S are:

1. When an S earns income, the individual owner(s) pays tax on their share of that income. Cash can later be distributed to the owner(s) free of tax. In contrast, when a C earns income there is a tax at the corporate level and at the individual level if distributed.
2. C does not separately state items of income or loss. One tax rate is imposed on the combined income. Since income doesn't retain its original character in a C, many of the benefits available at the individual level are lost.
3. Shareholder's stock basis in a C corporation does not increase as profits are earned. S shareholder's stock basis is increased to the extent previously taxed income isn't distributed. Upon the subsequent sale or liquidation of the corporation's stock, the S corporation shareholder keeps a greater amount of after-tax proceeds.

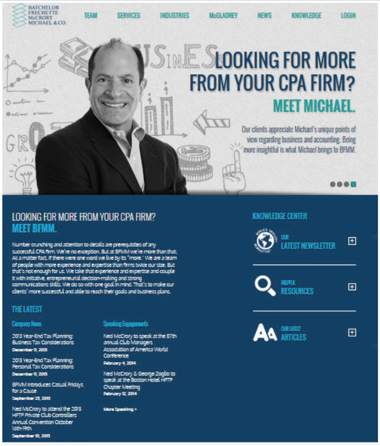
You may be lowering your current tax obligation by being a C and having the C pay the taxes at a lower rate. However, we suggest you avoid that immediate reaction as it is short-sighted. The S advantages during the operating period are important, but the avoidance of double taxation when the business is sold becomes even more compelling.

All the best,

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

THINGS TO KNOW

- Flow through entities are the preferred structure for private business owners.
- A sale of business assets by a C corporation and a subsequent liquidation triggers double taxation.
- FICA tax is not owed on the regular business earnings of an S corporation, only on salaries paid to employees. This is an advantage over partnerships and limited liability companies.



Michael Resnick of the Tax Practice Group on the new BFMM website.

For more information on tax services, visit bfmmcpa.com.

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Return Service Requested

Did you know?

1. The number of S corporation tax returns filed in 2012 more than doubled those filed by C corporations and exceeded partnership filings by more than 1 million returns.
2. For the first time in a decade, the top rates for individual and corporate income tax are not equal.
3. The American Taxpayer Relief Act of 2012 returned the top individual rate to 39.6% (not counting new Medicare taxes), while the top corporate rate remains unchanged at 35%.
4. Congress is discussing tax reform to lower statutory rates for C corporations as lawmakers agree that U.S. corporate rates are no longer competitive with our worldwide trading partners.
5. Most buyers of businesses prefer to acquire the assets of the business rather than its stock or partnership interest.
6. Flow through entities such as S corporations, partnerships and limited liability companies are not taxed at the entity level but instead are taxed on income only at the individual level.
7. If you terminate your S election you must wait five years to re-elect S corporation status.