Is an S Corporation Right for You?

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Alvina Lo :	Aloha. We're coming to you live from the floor of the Hawaii Tax Institute. I'm Alvina Lo, Chief Wealth Strategist of Wilmington Trust. And today, we're joined by two very special guests. Brian Janowsky, who is counsel at Schiff Hardin from New York City. And Olga Bogush who is a partner at Schiff Hardin.
.	Given what we have since tax reform a year ago and the new deductions that's now available to S corp. holders, I feel like S corp. has gotten a resurgence so to speak, in terms of importance, especially with business owners.
Olga Bogush:	Well, I think S corporations have, become a tool where they can be utilized to obtain a higher 20% deduction than you can in the case of partnerships.
	The reason for that is because in the case of S corporations, any payments, any compensation payments that are made to shareholders that are also employees, they count towards the limitation that are used to determine the 20% deduction.
Alvina Lo:	Would you recommend people restructuring based on these tax benefits?
Olga Bogush:	I think S corporations should be kind of approached with caution because the structure is so inflexible.
	Once you go into the S corporation kind of construct, it's very hard to unwind the structure, because unlike the partnerships that can be easily unwound with minimal tax cost, S corporation is very difficult to unwind because , to the extent that there is built in gains and the assets are within S corporation, then you can’t really dissipate it without triggering tax on the gain.
Alvina Lo:	When you have a business owner come to you and say, "Hey, you know I'm forming a new business," right? What are some of the factors or the questions that you would ask them to consider before determining what is the right entity choice to do?
Olga Bogush:	Some of the things we would want to know is what kind of, what kind of business this entity would be engaged in, right? Whether the entity would have employees, whether it would hold real estate. Depending on the nature of the business, right, and the desirability to obtain the 20% pass-through business deduction. I think the decision would be made using those considerations.
Alvina Lo:	Can you talk to us from a planner's perspective when you're talking to clients and they do want to plan with an S corp., what are some of the things you should look for?

Brian Janowsky: The first thing we have to speak with a client about is what are the various restrictions that might exist with transferring their S corporation shares. Who is a valid shareholder of an S corporation? This is a very important subject because, if you transfer a share in an S corporation to somebody who can't hold one, or to an entity does not qualify to hold S corporation shares, you can actually trigger the termination of the S election, which can have some pretty dire tax consequences.

Alvina Lo: What about in terms of a taxation benefit as relates to say a C corp., is there any benefits there?

Olga Bogush: Well of course because C corps. they’re entities that are subject to essentially double taxation, right? So, you have income that's being earned by the C corp. It’s taxed within the C corp. at the corporate tax rate. And then when the income is distributed to the shareholders, then it’s taxed again in the hands of the shareholders. S-corp. is essentially a pass-through entity, so income is only taxed once.

Alvina Lo: One of the often objections, or I should say hesitations, I hear sometimes from clients about using S-corp. is that unlike some of the other entity choice there is not a step-up in basis. How would you counsel clients about that?

Brian Janowsky: It’s true, it does not get the same kind of step-up in basis opportunity that a partnership would get. In a partnership, you can make an election when someone passes away that steps the internal basis of the assets within the partnership up to meet the fair market value of the partnership interest itself. With an S corporation, the same event does not occur. You do get a step-up in basis in the stock of the S corporation. But there's a way to structure around this to get almost the same benefit.

So the key is that in the year of the sale of the asset inside the S corporation, the proceeds are distributed out of the S corporation.

Alvina Lo: What are some pitfalls that people should be mindful about?

Brian Janowsky: I think with an S corporation, it's always the inadvertent termination issue. It's just so common, and there are ways to fix it. The problem is that to fix it costs quite a bit of money because you have to privately seek that relief from the IRS through a private letter ruling.

If you inadvertently terminate your S election, it causes that entire pocket of money that was already taxed once to get taxed again. So that's why it's very important to avoid these inadvertent terminations. And if you think an inadvertent termination has occurred, to take the right steps to remedy it.

For a deeper conversation on the issues discussed in this video please reach out to:

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