



S Corporations: Requirements

Course #3252B

Taxes

2 Credit Hours

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S CORPORATIONS: REQUIREMENTS

S corporations are currently the largest tax filer in the United States of America. This course covers the statutory requirements to be an S Corporation.

LEARNING ASSIGNMENTS AND OBJECTIVES

As a result of studying each assignment, you should be able to meet the objectives listed below each individual assignment.

SUBJECTS

Chapter 1: Requirements to Be an S Corporation

Study the course materials from pages 1 to 38

Complete the review questions at the end of each chapter

Answer the exam questions 1 to 10

Objectives:

- Recognize statutory requirements to be an S corporation.

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EXAM OUTLINE

- **TEST FORMAT:** The final exam for this course consists of 10 multiple-choice questions and is based specifically on the information covered in the course materials.
- **ACCESS FINAL EXAM:** Log in to your account and click Take Exam. A copy of the final exam is provided at the end of these course materials for your convenience, however you must submit your answers online to receive credit for the course.
- **LICENSE RENEWAL INFORMATION:** This course qualifies for **2** CPE hours.
- **PROCESSING:** You will receive the score for your final exam immediately after it is submitted. A score of 70% or better is required to pass.
- **CERTIFICATE OF COMPLETION:** Will be available in your account to view online or print. If you do not pass an exam, it can be retaken free of charge.

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CHAPTER 1: REQUIREMENTS TO BE AN S CORPORATION

Chapter Objective

After completing this chapter, you should be able to:

- Recognize statutory requirements to be an S corporation.

¶101 BASIC REQUIREMENTS

Because an S corporation is a creature of statute, Congress has prescribed that all of the following requirements be met for a corporation to achieve S corporation status:

- Have no more than 100 shareholders
- Have only eligible shareholders (e.g., individuals, decedents' estates, certain prescribed trusts, but not nonresident aliens)
- Be a domestic corporation
- Have only one class of stock

Tax Pointer 1



Even if a corporation meets all of the above requirements, it may not want S status because of the shareholder limitations. When parents who are eligible shareholders undertake estate planning, the S corporation limitations on trusts may make them opt for another business structure, such as a limited liability company classified as a partnership for tax purposes.

Tax Pointer 2



In terms of the definition of “domestic corporation,” it may be advantageous for a business to operate as a partnership for state tax purposes, but as an S corporation for federal tax purposes. For a discussion of this area, see ¶ 206.

¶102 COUNTING THE SHAREHOLDERS

.01 Meeting the 100-Shareholder Limit

An S corporation may not have more than 100 shareholders at any time during the tax year or it will lose its S status. Cumulatively, an S corporation may show more than 100 shareholders during a tax year due to transfers of stock, but the total shareholders at any one time cannot exceed 100.

In the case of S corporations which will exceed one hundred shareholders, shareholders may consider doing an “end run” around Code Sec. 1361(b)(1)(A)’s one hundred shareholder limit by forming a partnership of S corporations. Rev. Rul. 94-43 approved such a procedure. In Rev. Rul. 94-43, the IRS sustained a partnership of three S corporations, where each S corporation had the maximum number of shareholders permitted. So if three hundred shareholders wanted to operate as a single business, they could form three S corporations comprised of one hundred shareholders each, and have these three S corporations enter into a partnership to do business.

Care must be practiced in establishing partnerships with S corporations since the partnership anti-abuse regulations, Reg. § 1.701-2, will strike down attempts to utilize a partnership unless (1) the partnership is bona fide and each partnership transaction or series of related transactions (individually or collectively), is entered into for a substantial business purpose, and (2) the form of each partnership transaction is respected under substance over form principles.

.02 Stock Held by a Husband and Wife

When stock is held jointly by a husband and wife, either as joint tenants or as tenants in common, the husband and wife are treated as one shareholder, although both spouses must personally consent to the S corporation election. If a husband and wife each own stock separately as well as jointly, they are still treated as one shareholder.

Community property states. In a community property state, the husband and wife are treated as one shareholder if they each own stock, regardless of whether or not they each own stock as common property.

Death of a spouse. If a spouse dies, stock owned by the surviving spouse and the estate of the deceased spouse will be treated as one shareholder. Likewise, if both spouses die, the two estates will be treated as one shareholder.

.03 Stock Held with Children, Grandchildren, or Parents

An individual who owns stock with his or her children, grandchildren, or parents is counted separately along with the shareholder children, grandchildren, or parents (e.g., if a father and his two children are shareholders of an S corporation, they count as three shareholders, not one, for the 100-shareholder numerical limit). Constructive ownership rules do not apply in determining the 100-shareholder numerical limit.

Tax Pointer



See discussion at ¶ 202.08 where the family can file an election to be treated as one shareholder.

.04 Stock Held by a Nominee or Agent

If stock is held by a nominee, only the beneficial owner will be treated as a shareholder for the 100-shareholder numerical limit. Likewise, stock held by an agent is deemed to be stock owned only by the principal.

Example 2-1



ADF Inc., an S corporation, issued 15 stock certificates: 13 to individuals; one to Commerce Bank, who is the agent for Don Adams; and one to Bob Jones, who is holding the stock as a nominee for his three sisters, Doris, Martha, and Sally Jones. ADF Inc. has the following 17 shareholders, although only 15 certificates were issued: the 13 individuals, Adams, and the three Jones sisters.

.05 Stock Held by a Custodian

When stock is held by a custodian under the Uniform Transfer to Minors Act (UTMA), the minor is deemed the owner, not the custodian. Thus, if one person acts as a custodian for four different minors, there are four shareholders.

.06 Stock Held by Unmarried Joint Tenants and Tenants in Common

If two or more unmarried persons own S corporation stock as joint tenants, tenants in common, and so on, each person counts as a shareholder.

.07 Beneficial Ownership

Occasionally, stock is not issued to a shareholder; yet, the parties and the S corporation treat the taxpayer as a shareholder. Such a situation arose in the case of *Feraco*. In *Feraco*, a father and son owned the stock of the corporation. A third taxpayer, Bob Butler (“Butler”) was given an option to purchase stock in the S corporation; however, no stock was issued to him. Nevertheless, the S corporation issued a Form 1120S, Schedule K-1 to Butler each year that he was involved in the corporation. The Court held that Butler was a shareholder of the S corporation, even though he lacked legal title to the shares. In reaching its decision, the Court noted that besides Butler being listed as a shareholder on the S corporation’s tax return, Butler held executive positions typical of an owner of a corporation.