

Still Opportunities for S Corporation Elections to be Effective for 2014

C corporation shareholders often make an S election so that they can avoid the onerous double tax imposed at the corporate and shareholder level. The S election allows their corporation to be taxed as a pass-through entity with a single level of tax at the shareholder level. However, the S election comes with drawbacks, including the tax on "built-in gain" ("BIG") related to assets held while the entity was a C corporation. Historically, this BIG tax was imposed at the highest corporate tax level on the disposition of those specific assets held by the S corporation for 10 years after its election. The BIG tax made an S election unappealing for a C corporation that was considering a potential asset disposition in less than 10 years.

Limited relief from the BIG tax is now available for certain C corporation shareholders contemplating an S election. On December 19, 2014, President Obama signed into law H.R. 5771 which amends and extends a reduced period during which the BIG tax will be applied. Provided a C corporation makes an S election that is effective for any portion of 2014, it need wait only five years before it can dispose of assets and avoid the BIG tax. This extension continues for 2014 the treatment available for S corporation elections for tax years 2012 and 2013.

H.R. 5771 extended the five year BIG tax window only for 2014, not 2015. Therefore, the extension is of no use to a C corporation with a calendar tax year. However, for a C corporation with a fiscal year, H.R. 5771 provides an important planning opportunity if shareholders act by February 13, 2015. A C corporation with a fiscal year that ended other than on December 31, 2014 should be able to file a short tax year return as a C corporation and make the election to have another short year (for the single month of December 2014) as an S corporation. Thereafter, the S corporation would have a calendar year and, by 2019, could dispose of its assets without worrying about the BIG tax.

While H.R. 5771 does provide planning opportunities for C corporations with a fiscal year, shareholders should be cautious about making an S election. For example, there are limitations on the number and nature of S corporation shareholders. In addition, the S election must be made by all the shareholders of the C corporation within two and a half months after the beginning of the tax year for which the election is to take effect. Hanson



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Bridgett LP can assist shareholders of C corporations considering an S corporation election and provide guidance on many other corporate tax issues.

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