Hettick Accounting & Tax, LLC

2018 Tax Solutions for S Corporations

Dear Client:

An S corporation, such as yours, is a pass-through entity that is treated very much like a partnership for federal income tax purposes. As a result, all income is passed through to your shareholders and taxed at their individual tax rates. Unlike a C corporation, an S corporation's income is taxable to the shareholders when it is earned whether or not the corporation distributes the income. The current S corporation earnings passed through to shareholders are not considered dividends, which are taxed at the same rate applied to capital gains.

The attractiveness of S corporation status can fluctuate along with comparable individual and corporate tax rates. However, for tax years 2018 through 2025, the limitation on the business interest deduction, along with the reduction of income tax rates for corporations and the business income deduction for pass-through entities, help reduce the differences in marginal tax rates based on different sources of financing and in the choice of business entities.

Because an S corporation has a unique tax structure that directly impacts shareholders, it is important for you to understand the S corporation distribution and loss limitations, as well as how and when items of income and expense are taxed, before developing your overall tax plan.

In addition, 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 taxes, 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.

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

- the availability of the Code Sec. 179 deduction at the corporate and shareholder level;
- reporting requirements for the qualified business income (pass-through) deduction;
- business interest limitation;
- the tax treatment of fringe benefits;
- below-market loans between shareholders and S corporations; and
- IRS scrutiny of distributions to shareholders who have not received compensation.

We can assist you in identifying and maximizing the potential tax savings. Please call our office at your earliest convenience to arrange an appointment.

Sincerely,

Hettick Accounting & Tax, LLC

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