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**Nellie Akalp** • Sep. 08, 2022



*This is part 2 of a series on business conversions. [Click here for part one.](#)*

Many factors determine what kind of business structure your clients choose when starting their businesses. But whatever structure your clients launched with, at some point, for various reasons, changing structures may become a valid consideration. Although typically, clients choose to convert from a C Corp to an S Corp to avoid the C Corp's double taxation, there are reasons to convert in the opposite direction. Here's more to know about S Corp to C Corp entity conversions so you can help your clients make an informed decision.

## Why a C Corp?

Your C Corp clients likely went in that direction for the liability protections and 21%

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organizational requirements may seem cumbersome. A C Corp must have an elected Board of Directors responsible for all critical business decisions. Also, a C Corp must create and file Articles of Incorporation and bylaws with the state, meet regularly, keep shareholder board minutes, and comply with the Secretary of State's requirements for C Corps in each state where they conduct business.

Tax considerations also make C Corps stand apart from other legal structures. Because the corporation is a separate legal entity from the owners, the company is responsible for filing and paying its own taxes. Then the owners pay taxes on their salaries and dividends, causing "double taxation." Some companies prefer to file taxes as an S Corp to avoid double taxation.

## **Why an S Corp?**

The S Corp is an IRS election that changes the corporation's tax status to a "pass-through entity" under Subchapter S of the Internal Revenue Code. S Corps, therefore, are not separate taxable entities—the profits and losses are "passed-through" and reported on the personal income tax returns of the shareholders.

Generally, an S Corp is exempt from paying federal income tax other than the taxes on some capital gains and passive income. S Corp shareholders can save on taxes by dividing the company income into wages and dividends. Also, as a business owner or an employee, your clients must pay Social Security and Medicare taxes. As an employee, your clients are only responsible for part of these taxes, and the company pays the balance. However, when your clients organize as an S Corp, they have the flexibility to classify some of the business's income as salary and some as dividend distribution. That means your clients will still be subject to self-employment taxes on the wage portion of their income but pay only income tax on the dividend portion. Depending on how they divide their income, filing as an S Corp could save your clients a significant amount on self-employment taxes.

## Why Convert to a C Corp?

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misses the deadline.

- Tax Form 2553 must be signed by all shareholders
- The company must be filed as a U.S. corporation
- Can maintain only one class of stock
- Limited to 100 shareholders or less
- Shareholders must be individuals, estates, or certain qualified trusts
- Requires each shareholder to have a U.S. Social Security Number
- All shareholders must be U.S. citizens or resident aliens
- The corporation must have a tax year ending on December 31

Consequently, if any of these requirements are not met, your clients must convert the company's tax status. For example, your clients may want to bring on more than 100 shareholders, shareholders who are not U.S. citizens, or offer different kinds of stock. C Corps do not have limitations on the type of stock offered, the number of shareholders, or on the citizenship of shareholders.

Another reason for conversion is that the IRS tends to keep a close eye on S Corp returns, as the possibility for abuse is high. Business owners must be careful to portion themselves a "reasonable salary" consistent with position and responsibility—and not hide from payroll taxes by issuing excessive dividends.

## Converting the S Corp to a C Corp

Fortunately, your clients can convert their S Corp to a C Corp at any time and with relative ease. The business must submit a "[statement of revocation](#)" to the state service center where their annual return is filed.

The revocation statement must state that the company wishes to revoke the election made under Section 1362(a). In addition, the statement should include:

- Name of the shareholder(s)

- Address of the shareholder(s)

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non-voting).

To have the conversion take effect on the first day of the company's taxable year, your clients must submit the statement by the 16th day of the third month of the tax year, in other words, by March 15.

Entity conversions may seem like a complex decision for your clients; however, with your expertise and advice, the process can be accomplished seamlessly and win you a client for life.

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*Nellie Akalp is a passionate entrepreneur, small business expert, and mother of four. She is the CEO of [CorpNet.com](https://corpnet.com), a trusted resource for Business Incorporation, LLC Filings, and Corporate Compliance Services in all 50 states. Nellie and her team recently launched a partner program for accountants, bookkeepers, CPAs, and other professionals to help them streamline the business incorporation and compliance process for their clients. More info at: [CorpNet.com/partners](https://corpnet.com/partners).*

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