CPA Practice Advisor

Corporations

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Nellie Akalp • Feb. 23, 2024

By Nellie Akalp.

In the hectic world of finance and business, staying ahead of the curve is crucial. As trusted advisors to your clients, you are central in guiding them through the maze of business structuring options. While the Limited Liability Company (LLC) has long been a popular choice, other alternatives may better suit your clients' needs. Let's explore two noteworthy possibilities:

1—S Corporations (S Corps)

S Corp Qualifications

The S Corp is not a legal business entity. Instead, it is a special election made by either an LLC or C Corp with the Internal Revenue Service (IRS). An S Corp must report corporate income, losses, and deductions through its shareholders/owners, and in turn, the shareholders/owners report company income on their personal income tax returns.

Like C Corps, S Corps can sell shares of stock and have "perpetual existence," meaning the company will continue to exist after the owners leave or pass away.

To maintain S Corp election, the company is required to:

- Be filed as a U.S. corporation.
- Maintain only one class of stock.
- Limit the number of shareholders to 100 or fewer.
- Only permit shareholders who:
    - Are individuals, estates, or certain qualified trusts
    - Are citizens of the United States or permanent residents
    - Have U.S. Social Security numbers
- Have a tax year ending on December 31

And finally, each shareholder must consent (in writing) to the S Corp election.

Advantages and Disadvantages of the S Corp

The S Corp election has many advantages, making it an attractive option for businesses seeking tax savings and liability protection. For LLC members, opting for S Corp status may alleviate the burden of self-employment taxes. For C Corps, the S Corp election helps sidestep the issue of double taxation and preserves more earnings for reinvestment or distribution among shareholders. Plus, as stated above, being an

However, the S Corp does have some limitations and drawbacks. For example, the restriction on the number of shareholders, capped at 100, may hamper growth and investment potential. Also, S Corps may attract closer scrutiny from the IRS, potentially leading to more audits and compliance issues. The lack of uniform tax treatment across states can create complexities and additional compliance burdens for businesses operating in multiple states. Furthermore, the flow-through taxation characteristic of S Corps, while advantageous in some cases, may result in shareholders facing higher individual tax rates, particularly if the company's income pushes them into higher tax brackets. Lastly, owners who perform "substantial work" as employees must adhere to payroll tax requirements.

2—Benefit Corporations

Benefit Corporations—or B Corps—represent a growing trend in corporate entity choices, focusing on the company's social and environmental impact and financial success. Created to "merge the traditional for-profit business corporation model with a non-profit model by allowing social entrepreneurs to consider interests beyond those of maximizing shareholder wealth."

B Corp entities are legally obligated to consider stakeholders' interests beyond the shareholders, aligning with the increasing demand for businesses to operate with purpose and social responsibility. While B Corps offer the opportunity to impact society positively, they also come with unique compliance obligations and reporting requirements. Currently, only 36 states recognize the B Corp as a legal entity, so it's crucial to know whether your clients have this option.

B Corp Qualification

While certification is not necessarily required to register a business as a Benefit Corporation in a state, many companies decide to get certified because the official designation is publicly recognizable and shows the company's commitment to being

Secretary of State's office and submit an annual report (which is also required to keep certification). B Corps are taxed like other for-profit corporations, so the benefits are purely for the marketing clout and to distinguish the company as a socially responsible business motivated by good intentions.

Informed Decisions

As financial advisors, your expertise is invaluable in helping clients navigate the complexities of business structuring. You can provide personalized recommendations aligned with their objectives by assessing their goals, risk tolerance, and operational needs. Considerations such as tax implications, ownership structure, compliance obligations, and long-term viability should all factor into the decision-making process. By leveraging your expertise and staying "in the know" of regulatory changes, you can empower your clients to make informed decisions that set their businesses up for success.

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Nellie Akalp is a passionate entrepreneur, recognized business expert, and mother of four. She is the CEO of CorpNet, the most innovative way to start a business, register for payroll taxes, and maintain business compliance across the United States. Loved by entrepreneurs, accountants, and lawyers, CorpNet offers transparent pricing, a simple ordering process, and quickly scalable software and API solutions.

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