

To "C" or to "S"... Yes, you gotta choose.

08.22.13 | Linda J. Rosenthal, JD



So, as you might have figured out, one of those pesky requirements for forming a business in the United States is that you have to choose how your new enterprise is going to be viewed and taxed by the federal government.

That means that if you are a "for-profit" entity (benefit and [flexible purpose corporations](#) are still "for-profit") then you are going to get to choose between something known as a "C" Corp or as a "S" Corp.

Since the default is qualification as a C-Corp, if you wish to choose S-Corp status you need to file an election form with the IRS letting them know you've elected S-Corp status pretty darn quickly after you form your new business – so the time to decide how you want to be viewed is probably right NOW.

What are the similarities?

- **Liability Protection:** Shareholders in both corporate forms are generally* not responsible for the debts of the business or business liabilities.
- **Corporate Structure:** Both forms require a structure that includes provisions for shareholders, directors, and officers.
- **Corporate Compliance/Filing:** Both forms need to file Articles of Incorporation, issue stock, adopt and follow bylaws, and hold director and shareholder meetings.

What are the differences?

- **Ownership:** C-Corps allow UNLIMITED shareholders and thus are a preferable choice for larger businesses or those that plan to offer shares to the public. Conversely, S-Corps are limited to a maximum of 100 shareholders – and they must be residents or citizens of the United States.

- **Shareholders:** When forming a C-Corp, you can choose to have several different strata of shareholders, ones whose votes count for more or less than other shareholders. Conversely, S-Corps have just a single type of shareholder.
- **Taxation:** Ok, this is the biggie. First off, for either entity, personal income tax is paid on dividends drawn from the company. That said, C-Corps also pay taxes at the corporate level, while S-Corps, like LLCs, are pass-through entities. In other words, C-Corps have a possibility of something you might have heard of as “double taxation.” In a C-Corp, corporate income is taxed at the corporate level, and dividends are taxed *again* at a personal level.
- **Capital:** In a C-Corp, the business can choose to retain profits as operating capital. The shareholders are not taxed individually if a C-Corp retains profits. On the other hand, regardless of whether shareholders receive their portion of dividends from a S-Corp, they are taxed on their personal income taxes. As such, S-Corp shareholders can end up paying taxes on profits they never personally received, but which the business entity itself, did. That can be a bit of a shocker come April 15th, so be aware of the consequences of your choice!