

What events will cause an S election to terminate? What would you recommend S corporations do to plan for an orderly termination of an S election?

If the S Corporation does not meet the criteria to be an S corporation, it will be terminated . The criteria are the following:

- Greater than 100 shareholders
- Creating more than one class of stock
- Electing an improper tax year
- If more than 25% of the gross income is from passive investment income for 3 consecutive years
- Must be an eligible corporation
- All shareholder must be eligible shareholders

A corporation may revoke or terminate the S election as long as the termination is timely. Termination must be made on or before the fifteenth day of the third month of the tax year it will be effective.

Response 2

Events that cause termination are if there are more than 100 shareholders, if more than one class of stock, if the business fails to be classified as a small business for part of the year, if the election is revoked, if all shareholders do not consent to the election. In addition, termination can occur if the passive income requirement is not met, which is that 25% of the corporations receipts are passive income for three consecutive tax years. Passive income includes rent, dividends, interest, annuities, and gains from stock sales.

A regular analysis of the election can be done to ensure that the requirements are met. If the termination is inadvertent, the S Corporation can take steps to disqualify the event and restore the status.

Response 3

- * Exceeding the 100-shareholder limit
- * Having an ineligible shareholder own some of the stock
- * Creating a second class of stock
- * Attaining a prohibited tax status
- * Selecting an improper tax year
- * Failing the passive investment income test for three consecutive years

To plan for an orderly termination of an s-corporation election 50 percent of the company's owners must agree to terminate an election. The shareholders that agreed to the termination

of the s-corporation election must sign a consent form with the effective date of the termination. This form should include the reason why they wish to terminate the s-corporation election and be notarized. A letter to the IRS should also be written and sent with the consent form. The timeliness of the revocation is also important. For the termination to be effective for the current year the revocation must be done on or before the fifteenth day of the third month of the company's taxable year. If the revocation is made after that window (not in the first 2.5 months) of the tax year then the s-corporation can not file as a corporation until the next tax year.

Reference

Anderson, K., Pope, T., & Kramer, J. (Eds.). (2010). *Prentice Hall's federal taxation 2010: Corporations, partnerships, estates, and trusts* (23rd ed.). Upper Saddle River, NJ: Prentice Hall.