



Planned FINANCIAL Services
YOUR PERSONAL CFO™

Sub-S Corporation (S-Corp) Update



Frank Fantozzi, CPA, MT, PFS
Registered Investment Advisor
President

SITUATION

Many times Sub-S Corporations will run afoul shareholder limitation rules.

PROBLEM

PLR 200441023 dealt with an S-Corp that was creating a split dollar program that involved 19 irrevocable life insurance trusts. The plan was a rather straightforward split dollar program. The trusts will contribute the "term costs" and the corporation will pay the balance of the premium. Upon death, the corporation will get back the greater of the premiums advanced or the cash surrender value. The IRS ruled that such a program did not constitute a second class of stock because it did not fundamentally effect the liquidation or distribution rights of the shareholders. (If such a plan was treated as a second class of stock, the corporation would lose its S status--an S-Corp cannot have two classes of stock by definition.)

SOLUTION

There have been several recent developments in the S-Corp arena that are noteworthy. The first development comes from a recent Private Letter Ruling 200441023. The other developments come from the recently passed American Jobs Creation Act tax law. The new tax law changes several aspects of the S-Corp rules:

- Currently, S -Corps are limited to 75 shareholders. Under the new law, all family members (including spouses and ex-spouses up to 6 generations!) will be treated as one shareholder.
- The maximum eligible number of shareholders will be increased from 75 to 100.
- If bank stock is currently owned by an IRA (Roth or regular) and the bank subsequently elects S status, these shares may continue to be held by the IRA. (Under present law, an S-Corp cannot be owned by an IRA) Note that this change of rules only applies to a bank S-Corp.

The tax law also contains other liberalizations of the S-Corp rules, but the above changes are the ones most likely to effect clients.

Continued on Page 2





Planned FINANCIAL Services
YOUR PERSONAL CFO™

SIGNIFICANCE

Probably some of these changes in S-Corp rules were motivated by larger families who were running into problems with the shareholder limitations. The bank/IRA change is probably driven by the needs of a specific taxpayer.

Whatever generates these rule changes, they are generally effective for tax years beginning after 12/31/2004.

It is always useful to see the S-Corp rules being relaxed!

7000 Fitzwater Road, Suite 230, Cleveland, Ohio 44141