

# WHAT IS THE DIFFERENCE BETWEEN A SUBCHAPTER C AND S CORPORATION IN ARIZONA?

*While C and S-Corporations Share Common Traits, There are Important Differences Between the Two Different Corporate Forms*



Both S-Corporations and C-Corporations are common ways for businesses to be organized. Both types of corporations involve the classification of the business as a separate legal entity distinct from its owners. Corporations have many of the same rights and the same responsibilities as individual citizens, and owners of corporations enjoy liability protections not available with other types of business entities.

While C and S-corporations share common traits, there are important differences between the two different corporate forms. An experienced business attorney can explain the distinctions between S-corporations and C-corporations and can assist your company in knowing which type of corporate structure is most appropriate.

## SUBCHAPTER S AND SUBCHAPTER C CORPORATIONS

S-Corps and C-Corps derive their names from the chapter of the Internal Revenue Code applicable to each business type. The term C-Corp refers to businesses that are organized under Subchapter C of the IRS code.

A C-Corp is the standard form for corporations and many large businesses throughout the United States are C-Corps. The term S-Corp refers to businesses that are organized under Subchapter S of the IRS code. Many small businesses are organized as C-Corps

The method of taxing business profits is one of the most fundamental differences between an S-Corporation and a C-Corporation. C-Corporations are taxed on profits that the company makes. When the company distributes its earnings to its owners in the form of either dividends or special payouts, the individual owners are also taxed on this income. As a result, C-corporations can be subject to having their income double taxed. This is an important thing to consider when deciding how to incorporate your business, as there could be a significant additional tax expense incurred if proper steps are not taken to limit the implications of double taxation.



S-Corporations are taxed differently than C-corps. S-Corporation profits and losses pass through to individual shareholders/owners, who then declare the

income or deduct the losses on their personal tax returns. S-Corporations can distribute money to shareholders as distributions of profits, rather than as salary. As a result, the shareholders of the company do not have to pay Medicare or Social Security taxes on this distributed income.

Some self-employed business people will incorporate as an S-Corporation



primarily to take advantage of this tax savings. Politicians have repeatedly tried to change the rules to prevent shareholders who also work closely with the business from realizing this tax savings, which is sometimes referred to as the “Gingrich-Edwards loophole” after the two

politicians who both saved significant sums of money by forming an S-Corp.

While the differences in rules related to taxation are widely viewed as the most important distinctions between C-corps and S-corps when deciding on the best business structure, there are other differences as well. For example, there are more restrictions on ownership of S-Corporations than ownership of C-Corporations.

C-Corporations can be owned by foreigners who are not U.S. citizens or resident aliens, while S-Corporations can be owned only by resident aliens or

citizens of this country. Other business entities, such as partnerships or other corporations, are also permitted to own shares of C-Corporations but not S-Corps. Finally, C-Corporations may have an unlimited number of shareholders while the number of investors who can co-own an S-corporation is limited.

C-Corporations also provide more flexibility not only in who owns a stake in the business but also in issuing stock. S-Corporations may issue just one category of stock and are not allowed to issue preferred stock. C-Corporations may issue all different types of stock, with different shareholders having different types of ownership interests.



Companies wishing to go public in the future may prefer organization as a C-Corporation rather than as an S-Corporation. This can make it easier to sell shares of stock on an open market after a future Initial Public Offering (IPO).

An experienced attorney can explain the important differences between S-Corps and C-Corps and help you to decide on the appropriate business structure. If an S-Corp is the right choice, the corporation must file for S-Corporation Status by the 16<sup>th</sup> of the third month of the tax year in which the election is due or must file the S-corp election any time in the tax year

preceding the year in which the business wishes to begin operating as an S-corp.

If the election is made during the preceding year, it must be completed within 2 ½ months of the beginning of the tax year. If the S-Corp election is not submitted on time, it will not be considered valid for the tax year and the business and its owners will not get the tax benefits that come with being organized as an S-corporation.

C-Corporations do not require any forms to be submitted to elect C-Corp status. When a company incorporates, it is assumed to be organized as a C-



corporation unless it has completed the paperwork to be classified as a Subchapter S corporation.

Both C-Corporations and S-Corporations provide similar liability protection to owners, generally limiting the

shareholder's risk of loss to the actual value of investments as long as corporate formalities are maintained.

An experienced attorney can assist with S-Corp election as well as with other aspects of forming a corporation. To learn more or for help forming a corporation, contact a business law attorney who can represent your interests.

## About the Author

Lotzar Law Firm, P.C. was founded in 2005, and serves clients throughout the U.S. We pride ourselves on the level of service we provide our clients and are determined to see each project through to positive results.

In addition to bringing a legal expertise to the table, we offer clients sound ideas and invaluable advice that enhances their business. One of our greatest attributes is our ability to approach projects from a business-owner perspective. Rather than narrowing in on the setbacks of a challenge and informing clients of what stands in the way, we prefer to seek innovative ways to transcend issues and create a better path for clients. With an unparalleled savvy in developing modern methods of financing, we can present you with viable and efficient options.

Our diversified portfolio of clients is comprised of entrepreneurs, real estate developers, contractors and property managers. We also do business with numerous nonprofit clients including Chicanos Por La Causa, Inc.; Tiempo, Inc.; and The Industrial Development Authority of the City of Tucson, Arizona.

We work in a team-based environment, supported by a skilled and caring staff, eager to answer your questions and provide you with consistent access to your team. Whether your needs are small or large in scope, we look forward to working with you.

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