**8789. What is an S corporation and how is it formed?**

An S corporation is a corporation that files an election to be treated as an S corporation, which, generally, means that it will be treated as a pass-through entity that is taxed similarly to a partnership, thus avoiding most tax at the corporate level.[[1]](#footnote-1) To be eligible to make the election, a corporation must meet certain requirements as to the kind and number of shareholders (Q 8794), classes of stock (Q 8795), and sources of income. However, the decision to be an S corporation is a tax election. Therefore, an S Corporation will be treated the same as any other corporation for purposes of the applicable state corporation law.

An S corporation must be a domestic corporation with only a single class of stock and may have up to 100 shareholders (none of whom are nonresident aliens) who are individuals, estates, and certain trusts. An S corporation may not be an ineligible corporation.

An ineligible corporation is one of the following: (1) a financial institution that uses the reserve method of accounting for bad debts; (2) an insurance company; (3) a corporation electing (under IRC Section 936) credits for certain tax attributable to income from Puerto Rico and other U.S. possessions; or (4) a current or former domestic international sales corporation (DISC). Qualified plans and certain charitable organizations may be S corporation shareholders.[[2]](#footnote-2)

While an S corporation can only have one class of stock, it is permitted to have a second class of stock if the only difference is the ability to vote.[[3]](#footnote-3)

**Planning Point**: In order to qualify as an S corporation, an election must be filed in order to be treated as such. These elections are made on IRS Form 2553, and must be made within two months and fifteen days after the effective date of the election. The IRS has recently issued Revenue Procedure 2013-30, which will extend this time period for up to three years for certain situations.

1. . See IRC Secs. 1361, 1362, 1363. [↑](#footnote-ref-1)
2. . IRC Sec. 1361. [↑](#footnote-ref-2)
3. . IRC Sec. 1361(c)(4). [↑](#footnote-ref-3)