**8805. When can estate planning considerations impact a choice of entity decision?**

Both C corporations and S corporations may take advantage of opportunities to provide liquidity and reduce estate taxes at a shareholders death. These techniques include:

*Section 303 stock redemptions*. IRC Section 303, designed to provide liquidity and prevent the forced sale of businesses to pay income and estate taxes, provides that income from certain partial redemptions of stock to pay death taxes will be treated as a sale of stock rather than a dividend. Where stock included in the adjusted gross estate of a shareholder (without regard to family attribution-of-ownership rules) equals a certain percentage of the gross estate, the corporation can redeem from the estate a quantity of stock equal in value to the total of the deceased’s federal estate tax, state death taxes, and funeral and administrative taxes.

*Gifts of stock*. Because corporate ownership is easily divisible, shareholders can give close corporation stock to family members, charities, etc. These gifts can shift income to lower-bracket family members, remove future appreciation from the shareholder’s future estate, and even provide an income tax deduction in the case of charitable gifts. S corporation shareholders must take care to insure that such gifts do not jeopardize S corporation eligibility.

**Planning Point:** When making gifts of stock, it is important to review any shareholders agreements which may exist in order to make sure the stock is transferable in the desired manner. It may be necessary to obtain certain consents from the corporation or other shareholders in order to complete the transfer.

**Planning Point:** Since, however, it is permissible for an S corporation to issue non-voting stock, estate planning opportunities exist whereby the non-voting stock can be transferred without relinquishing control. Also, since the transferred stock in this context is non-voting, it is entitled to an adjustment to reflect the lower value associated with this type of stock.

*Estate freeze techniques*. Some shareholders in closely-held corporations may reduce their eventual taxable estate by recapitalizing the corporation to “freeze” the value of stock included in their estates and pass future appreciation on to family members. Interests transferred in this fashion will be treated as gifts and valued according to special valuation rules (see Q 8837).

See Q 8806 to Q 8825 for a discussion of business succession techniques, including buy-sell agreements and redemptions, that may be useful in the small business context.

**Planning Point:** If, however, an S corporation is going to pass through an estate, consideration should be given as to whether the stock is going to pass into a trust. If so, the trust must qualify as either a QSST or ESBT.