

AMERICAN BAR ASSOCIATION -- SECTION OF TAXATION

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TITLE: Corporation's Status as an S Corporation Due Diligence Checklist

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**2006 Joint Fall CLE Meeting  
Denver, CO  
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**Corporation's Status as an S Corporation  
Due Diligence Checklist**

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Validity of S Election

1. Is the corporation eligible?
  - a. A domestic corporation?
    - i. An eligible entity may elect corporate status; S election filed on or after 7/20/04 is a deemed corporate election
    - ii. For eligible entities timely electing S status pre-7/20/04, is a deemed corporate election
    - iii. For eligible entities whose S election was not timely pre-7/20/04, separate election to be a corporation under § 301.7701-3 required (see RP 2004-48 for administrative late election relief)
    - iv. Corp organized under US and foreign law is domestic -- § 301.7701-5T
    - v. Certificate of Incorporation or other document required by local law issued, not rescinded?
  - b. Was it an "ineligible corporation"?
    - i. For tax years beginning before 1/1/97, the following were not eligible to be S corps: (1) a bank, domestic building and loan assn, mutual savings bank or co-op bank; (2) a corp that elected to have the § 936 possessions credit apply; (3) a DISC or former DISC; (4) insurance company.
    - ii. For tax years beginning after 12/31/97, (1) financial institution that uses reserve method of accounting and 2 thru 4 above are not eligible.
  - c. Eligible shareholders?
    - i. How many are allowed:

1. Before 1/1/97, no more than 35 shareholders (Husband and Wife treated as one)
  2. Between 12/31/96 and 12/31/2004, no more than 75 (H and W treated as one)
  3. After 12/31/2004, no more than 100 (members of family treated as one)
- ii. Type of shareholder?
1. Individual who is not a nonresident alien? If community property, spouse may not be a nonresident alien either.
  2. Estate
  3. Domestic trust that --
    - a. Is a trust treated as wholly owned by an individual who is a citizen or resident of US, including a QSST
    - b. Was a trust described in (a) before deemed owner's death but only for 2 years after death
    - c. Trust to which S stock transferred by will, but only for 2 years after transfer
    - d. Voting trust
    - e. ESBT for years after 12/31/96
    - f. In the case of an S corporation bank, an IRA or Roth IRA, but only to the extent of the stock held by such trust in such bank as of 10/22/04
  4. A tax-exempt § 501(c)(3) organization or a tax-exempt § 401(a) retirement trust for years beginning after 12/31/97
- iii. One class of stock only?
1. Disproportionate distributions?
  2. Poorly documented "loans"?
  3. Fringe benefits to non-employee shareholders?
- iv. Type of assets/income
1. For elections effective before 1/1/97, did the corporation own 80% or more (by vote and value) of another corporation?
  2. If the corporation has E&P (because it has or has acquired an entity with E&P), does the corporation have passive investment income? How much? For how long?

2. Was a proper election made?

- a. Form 2553 filed timely; IRS acceptance letter?
- b. Are the required consents included?

- i. Check name, marital status and state of residence of each shareholder.
  - ii. Were there any shareholders who owned stock at any time during period between filing of election and effective date?
  - iii. Special consents required for – a minor, grantor trust, QSST, ESBT, estates, §501(c)(3) orgs and § 401(a) trusts.
  - iv. Consent of corp by authorized officer?
3. Has the election terminated because of failure to meet any requirement to be an S corp (see above) since the effective date of the election?

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