



Staying Ahead of Tax Law Changes

Summary:

A family owned S Corporation with \$30 million of investment assets protects its preferred tax structure and saves tax dollars in an ever changing tax rate environment.

Challenge:

A family owned S Corporation which now holds investment assets for the family at one time was an operating business structured as a C corporation. There were significant C corporation earnings and profits which had built up over time that had not been distributed.

The passive investment nature of the current S corporation combined with the undistributed C Corporation earnings and profits put the current S corporation status of the entity at risk. The IRS rules called for automatic revocation of the S corporation status unless a structural change occurred. Additionally the federal tax environment clearly indicated that significant tax rate changes, particularly to qualified dividends, were on the horizon. Finally cash was at a premium and disposition of investment assets would be necessary to generate significant additional amounts of cash.

Solution:

The tax team at GBQ suggested the following planning to the client. If 100% of the built up C corporation earnings and profits were distributed to the shareholders, the passive investment issue went away and the tax preferred S corporation status would continue. Further, this distribution would qualify for a 15% dividend tax rate, a temporary rate reduction which is the lowest rate on this type of income in over 50 years. Finally a special election was made whereby the S corporation did not have to liquidate portfolio assets to make the distribution but rather the corporation made a deemed distribution of the long standing C corporation earnings and profits. There was enough cash to distribute to pay the 15% taxes without having to liquidate investment assets.

Benefits:

GBQ assisted the client in the following ways:

1. The entity no longer has to worry about the so called passive investment income test and will be able to retain the S corporation status regardless of their family investment business operations.
2. A historically low tax rate was utilized to make the distribution. The tax rate which would apply had this transaction occurred just 24 months later would be more than 2.5 times higher.

By utilizing an election in the tax code to take a deemed dividend the client was able to conserve their