Stephen A. Macy, CPA, PA
S Corporation vs. C Corporation
Basic Theory with Example

A C Corporation (sometimes called a "regular corporation") pays its own income tax obligations. If there is money available after paying its income tax obligations, it pays DIVIDENDS to its shareholders. C Corporations only declare and pay dividends to their shareholders when their cash flow allows them to. The shareholders then pay a second tax on the dividends paid them at their tax bracket rate. This results in a double tax. One at the corporate level, a second one at the individual shareholder level (note that dividends are paid after taxes by the C Corporation not before taxes and dividends paid to shareholders are not deductible by the C Corporation). **If a C Corporation has net taxable income, it must pay its own tax regardless of whether it ever pays dividends to its shareholders or not.**

An S Corporation (referred to as a "pass-through entity") does not pay income tax on its net taxable income. The shareholders each pay tax on their proportionate share of the S Corporation's net taxable income. S Corporations pay SHAREHOLDER DISTRIBUTIONS to each shareholder based on the shareholders' proportionate ownership percentage. The S Corporation is not required to make distributions and sometimes they cannot do so due to cash flow needs of the corporation. **Understand that even if distributions are not paid to the shareholders of an S Corporation, the shareholders must still pay income tax on their share of the S Corporation's net taxable income. It is the net taxable income of the S Corporation that creates the tax liability - not the distribution to the shareholder.** With some tax law-based exceptions, distributions paid to shareholders of an S Corporation have no impact on the tax liability of the shareholder. Distributions are paid from "pre-tax $" and are not taxed a second time when received by the shareholders.

Below is a simple example to demonstrate the differences between the two types of corporations.

Assumptions:

Corporate combined federal and state income tax rate 30%
Individual shareholders assumed to be in a 30% tax bracket
Both corporations have: Sales $100,000 Expenses $50,000 Net Taxable Income $50,000
C Corporation pays shareholders $10,000 in dividends
S Corporation pays shareholders $10,000 in shareholder distributions

C Corporation Results:

			Tax
Net Income	50,000		
Federal & State Income Tax	(15,000)		15,000
Net After Tax Income	35,000		
Dividends paid	10,000		
Shareholder tax on Dividends	3,000		3,000
		Total Tax	18,000

S Corporation Results:

			Tax
Net Income	50,000		
Corporate Income Tax	0		
Distributions paid	10,000		
Shareholders' tax responsibilities:			
Net Income reported by S Corp.	50,000		
Individual Federal & State Inc. Tax	(15,000)		15,000
Distributions paid to/received by Shareholder	10,000		
Shareholder tax on Distributions	0		0
		Total Tax	15,000

Note in our example, the S Corporation shareholder only received $10,000 in distributions; however, the shareholder must still pay the $15,000 tax on the net income. This situation can occur. Generally, though, distributions exceed any tax liability of the shareholder resulting from the S Corporation's net taxable income.

13770 58th St. N., Suite 304, Clearwater, FL 33760 Phone: (727) 544-8875