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ENDING THE CONFUSION REGARDING CONVERSION TRANSACTIONS OF THE LLC & NON-LLC

The Internet is fueling a technology and information revolution. Never before in human history have people been able to look up anything (and I mean anything) by using a pocket held device which offers instant results. The same is true in the legal and tax world as well. Twenty years ago, someone with sufficient knowledge of tax law was needed to file a form 1040. Today, you look up your question and a popular web search brings you your answer. No trip to the library needed, no experience in research necessary. This leap in information has even reached business owners, and they are now asking, "Is my choice of entity appropriate for what I am doing?"

This article applies to both LLCs and non-LLC businesses. We have to point that out for clarity because the LLC can "check the box" and take any form when selecting its manner of tax.

Converting from a C Corporation to an S Corporation

The default rule with the IRS for any incorporated entity is Subchapter C status. An S Corporation is an incorporated entity in which the shareholders have elected tax status under Subchapter S of the Internal Revenue Code. Form 2553 is used to make this conversion, requiring consent of

the shareholders.

When converting an entity from a C corporation to an S corporation, there is the potential for Built in Gains tax. Built in Gains items are simply gains that could potentially be triggered at the sale of an item if that asset is sold for gain within 5 years of the C to S conversion. There are strategies to prevent this from happening. Converting

from a C Corporation to an S Corporation, is *not* a taxable event. This manner of conversion can be useful when an old corporation (potentially formed in the 60s and 70s, S Corporations were not yet popular) is in a situation where the company and shareholder pay two levels of tax and wants to get out of C status.



From an S to a C

This transaction is low risk in so far as potential to trigger a tax is unlikely. All one must do is revoke the S Corporation election by filing a statement that it is revoking the election under Section 1362(a). Shareholders representing more than half of the outstanding shares must consent to this in a written instrument. Converting from an S to a C is useful when a company is making a fair amount of money and the owner wants the money to be shielded from his tax return. The conversion is generally not a taxable event.