



## LAW ADVOCATE GROUP, LLP

9701 Wilshire Blvd. Suite 1000 Beverly Hills, CA 90212

Phone: 310-651-3065 Fax: 310-601-7110

[www.LawAdvocateGroup.com](http://www.LawAdvocateGroup.com)

# Doron F. Eghbali Business Formation Law

## [What Are Some Latent S Corporations Pitfalls?](#)

Tuesday, February 15, 2011 by [Doron F. Eghbali](#)

S Corporations could be regarded as favorable business structures since shareholders could avoid double taxation and take advantage of protecting their other assets against liability except the ones invested in the S Corporation. Nonetheless, there are salient caveats before embarking on forming an S Corporation as opposed to other forms of business entities, especially LLCs. Let us intelligently and incisively explore some of the issues in more depth.

### **SOME BACKGROUND ON S CORPORATIONS**

One of the most advantageous characteristics of S Corporations is the ability to avoid double taxation i.e. paying taxes at both corporate and individual level. In S Corporations, income is taxed like partnerships. Each item of income is "passed through" directly to the shareholders and it is not taxed at all at the corporate level.

This "pass-through" advantage provides owners of S Corporations with the advantages of corporate form such as centralized management and limited personal liability, while avoiding double taxation.

### **SOME LATENT PITFALLS IN S CORPORATIONS**

- **S CORPORATION GENERATION OF OPERATING LOSSES:** If a business is expected to generate losses, LLC could be more advantageous than an S Corporation. This is because S Corporation shareholders cannot write off losses exceeding their actual investments. In other words, S Corporation shareholders can write off losses equaling their investments PLUS any other amounts they are "at risk". On the other hand, LLC members could write off investments equaling their investments PLUS their ALLOCABLE SHARE OF LLC DEBT.



- **S CORPORATION ALLOCATION OF LOSSES AND PROFITS:** In S corporations, profits and losses are distributed among shareholders in proportion to their stock ownership throughout the year. On the contrary, generally, LLC members could agree to allocate profits and losses disproportionately. This means LLC members could agree to allocate profits on one basis and allocate losses on another basis.
- **S CORPORATION LIMITATION TO ONE CLASS OF STOCK:** S Corporations are limited to one class of stock while LLCs can have different financial interests.
- **S CORPORATION PROSCRIPTION FOR FUTURE SERVICES OR UNSECURED PROMISES:** S Corporations are proscribed to become shareholders for future services or unsecured promise to pay. In contrast, LLC membership can be obtained through future services or any other obligation to pay including a promise to pay.

### CAVEAT

This article provides *ONLY SOME* of the issues relevant to S Corporations. For any questions, you may contact [Doron Eghbali, Esq.](#)

---

[\*\*DORON EGHBALI\*\*](#) is a Partner at the Beverly Hills Offices of [Law Advocate Group, LLP](#). He Primarily Practices [Business](#), [Real Estate](#) and [Entertainment Law](#). [Doron](#) Can Be Reached at: 310-651-3065. For More Information, Please, Visit: [HERE](#).