**S Corporation vs. C Corporation: The Similarities**

The [C corporation](https://www.bizfilings.com/starting-your-business/business-types/c-corporation) is the standard (or default) corporation under IRS rules.  The [S corporation](https://www.bizfilings.com/starting-your-business/business-types/s-corporation) is a corporation that has elected a special tax status with the IRS and therefore has some tax advantages.

Both business structures get their names from the parts of the Internal Revenue Code that they are taxed under.  C corporations are taxed under Subchapter C while [S corporations](https://www.bizfilings.com/toolkit/research-topics/incorporating-your-business/what-is-an-s-corporation) are taxed under Subchapter S. To elect S corporation status when forming a corporation, Form 2553 must be filed with the IRS and all S corporation guidelines met.

Here are some of the qualities shared by both C corporations and S corporations:

* **Limited liability protection:** Corporations offer limited liability protection, so shareholders (owners) are typically not personally responsible for business debts and liabilities. This is true whether it is taxed as a C corporation or an S corporation.
* **Separate legal entities:** Corporations (C corps and S corps) are separate legal entities created by a state filing.
* **Filing documents:** Formation documents must be filed with the state. These documents, typically called the [Articles of Incorporation](https://www.bizfilings.com/toolkit/research-topics/incorporating-your-business/what-are-articles-of-incorporation) or Certificate of Incorporation, are the same regardless of whether you choose to be taxed as an S corporation or C corporation.
* **Structure:**[S corps](https://www.bizfilings.com/toolkit/research-topics/incorporating-your-business/what-is-an-s-corporation)and C corps have shareholders, directors and officers. Shareholders are the owners of the corporation, but it is the corporation that owns the business. The shareholders elect the board of directors. The board oversees and directs corporation affairs and decision-making but is not responsible for day-to-day operations. The board elects the officers to manage daily business affairs.
* **Corporate formalities:** The state corporation laws make no distinction between C corporations and S corporations when it comes to compliance responsibilities. All corporations are required to follow the internal and external corporate formalities and obligations, such as adopting bylaws, issuing stock, holding shareholder and director meetings, maintaining a [registered agent](https://www.bizfilings.com/starting-your-business/more-services/registered-agent) and registered office, filing annual reports, and paying annual fees.

**S Corporation vs. C Corporation: The Differences**

**Taxation**

For small business owners evaluating S corporations vs. C corporations, the decision usually comes down to how they want the corporation to be treated for federal income tax purposes.

* **C corporations:** C corps are separately taxable entities. They file a corporate tax return (Form 1120) and pay taxes at the corporate level. They also face the possibility of double taxation if corporate income is distributed to business owners as dividends, which are considered personal taxable income. Corporate income tax is paid first at the corporate level and again at the individual level on dividends.
* **S corporations:** S corps are pass-through taxation entities. They file an informational federal return (Form 1120S), but no income tax is paid at the corporate level. The profits/losses of the business are instead “passed-through” to the business and reported on the owners’ personal tax returns. Any tax due is paid at the individual level by the owners.
* **Personal income taxes:** With both C corporations and S corporations, personal income tax is due both on any salary drawn from the corporation and from any dividends received from the corporation.

**Corporate ownership**

As we mentioned, state corporation laws make no distinction between S corporations and C corporations. But the Internal Revenue Code does place several restrictions on who can be shareholders in order for the corporation to qualify to be an S corp.

* **Shareholder restrictions:** S corps are restricted to no more than 100 shareholders, and shareholders must be US citizens/residents. C corporations have no restrictions on ownership.
* **Ownership:** S corporations cannot be owned by C corporations, other S corporations (with some exceptions), LLCs, partnerships or many trusts.
* **Stock:** S corporations can have only one class of stock (disregarding voting rights), while C corporations can have multiple classes.

[Start a C Corp](https://www.bizfilings.com/starting-your-business/business-types/c-corporation)    [Start an S Corp](https://www.bizfilings.com/starting-your-business/business-types/s-corporation)

**S Corporation Advantages**

* **Single layer of taxation:**

The main advantage of the S corp over the C corp is that an S corp does not pay a corporate-level income tax. So any distribution of income to the shareholders is only taxed at the individual level.

* **20% qualified business income deduction**

The Tax Cuts and Jobs Act of 2017 gave eligible S corp shareholders a deduction of up to 20% of net “qualified business income”.

* **Pass-through of losses**

The losses of an S corp pass-through to its shareholders, who can use the losses to offset income (subject to restrictions of the tax law).

**S Corporation Disadvantages**

* **Limited number of shareholders**

An S corp cannot have more than 100 shareholders, meaning it can’t go public and limiting its ability to raise capital from new investors.

* **Other shareholder restrictions**

Shareholders must be individuals (with a few exceptions) and U.S. citizens or residents. This also makes it harder for an S corp to obtain equity financing, particularly because venture capital and private equity funds tend to be ineligible shareholders.

* **Preferred stock not allowed**

To be eligible for S corp status the corporation cannot have different classes of stock. Some investors want preferences to distributions or other privileges. An S corp cannot provide that.

* **Transfer restrictions**

Most S corps will restrict their shareholders’ ability to sell or transfer their shares. That’s to make sure they don’t end up with an ineligible shareholder which will cause the IRS to terminate its S corp status. This makes it harder for the shareholders of an S corp to exit the corporation.

**C Corporation Advantages**

* **Unlimited number of shareholders**

There is no limit on the number of shareholders a corporation taxed under Subchapter C can have.

* **No restrictions on ownership**

Anyone can own shares, including business entities and non-U.S. citizens.

* **No restrictions on classes**

A C corp can issue more than one class of stock, including stock with preferences to dividends and distributions.

* **Lower maximum tax rate**

The 2017 tax reform act lowered the corporate tax rate to a flat 21% and eliminated the alternative minimum tax. Even with the personal income tax rates being slightly lowered, this rate is lower than the maximum personal tax rate (which is currently 37%).

* **More options for raising capital**

Because Subchapter C of the tax code does not impose the same restrictions on ownership as Subchapter S, it is easier for a C corp to obtain equity financing.

**C Corporation Disadvantages**

* **Double taxation**

The main disadvantage of the C corporation is that it pays tax on its earnings and the shareholders pay tax on dividends, meaning the corporation’s earnings are taxed twice.

**When Would the Pros of an S Corporation Outweigh the Cons?**

There is no one size fits all answer to when a small business owner should choose an S corporation over a C corporation. It depends upon each individual situation. But the pros may outweigh cons when one or more of the following applies:

* You don’t plan on an IPO and are not looking to sell shares to more than 100 people or any other investors that are not permitted by Subchapter S.
* The corporation will be making distributions of income to shareholders.
* You don’t plan on issuing preferred stock.
* The shareholders’ tax liability—taking into account their personal income tax rate, deductions, and exemptions—will be lower using a pass-through entity than a separately taxed entity.
* You will have losses that you will be able to deduct from your personal income taxes to offset income, resulting in a tax saving.

**When Would the Pros of a C Corporation Outweigh the Cons?**

Again, there is no one right answer to that question, but here are some situations where a C corp may be a good option:

* Taxation under Subchapter C will result in lower taxes than taxation under Subchapter S.
* Distributions will not be made to shareholders.
* You plan on an IPO or seeking investors not allowed for an S corporation.
* You want shares to be freely transferable.
* You want to issue preferred stock.

**How to Become a C Corporation (C Corp)**

Actually, you don’t “become” or “form” a C corporation or an S corporation. You form a corporation—period. And you do that by filing a document, generally referred to as Articles of Incorporation (sometimes called a Certificate of Incorporation) with the state and pay filing fees.

Before you do, you have to choose a name (after first determining that it is available to you) and choose your corporation’s registered agent. Both the name of the corporation and the registered agent has to be included in the Articles of Incorporation.

After the incorporation process is completed, you will need to fulfill other requirements. These include adopting bylaws, holding an initial meeting of directors and shareholders, and issuing shares of stock to owners. Your corporation will be taxed under Subchapter C unless you qualify for, and elect to be taxed under Subchapter S.

**How to Become an S Corporation (S Corp)**

After you first become a corporation by filing your Articles of Incorporation with the state, you will need to file Form 2553 with the IRS if you wish your corporation to be taxed under Subchapter S. The IRS instructions—which can be a bit tough to follow—require that an election is considered effective in the current tax year only if the Form 2553 is completed and filed -

* Any time before the 16th day of the 3rd month (for calendar year tax payers, this means it needs to happen by March 15th)
* Any time during the preceding tax year. (However, an election made no later than 2 months and 15 days after the beginning of a tax year that is less than 2½ months long is treated as timely for that year).

Generally, an election made after the 15th day of the 3rd month but before the end of the tax year is effective for the next tax year (unless you can show failure to file on time was due to reasonable cause).

Keep in mind that some states also require you to file a state-level S corporation election after incorporating your business.

**What if You Want to Change How Your Corporation Is Taxed?**

When you first incorporated your business, you had to choose whether your corporation would be taxed as a C corp or an S corp.

But what if you change your mind later? This can happen, for example, because your business goals changed. Say you weren’t originally interested in an IPO but now you are. Or the tax laws changed, resulting in your corporation being better off taxed differently than before.

A lot of small businesses were reevaluating whether they should change from S corporation tax status to C corporation tax status, or vice versa, when The Tax Cuts and Jobs Act of 2017 was passed. This law made significant changes including—as noted earlier—reducing the corporation tax rate (which favored C corporations) and providing a special 20% deduction for pass-through entities (which favored S corporations that qualified for it). (The reduced tax rate was just one of many changes enacted.)

Tax laws are complex. And consulting with tax advisors will help you make the best decision as to how your corporation should be taxed, both at the time of incorporation and on an ongoing basis.

**Choosing between C Corp and S Corp: Which Is Best for Your Small Business?**

Your choice of entity type has a big impact on many aspects of your business, ranging from taxes to financing to growth strategies. Looking at the advantages and disadvantages of your options may help you come to a decision that best suits your unique business needs and goals.

To help you decide which corporate entity type might be best for you, try our Incorporation Wizard. This tool allows you to compare different business types by key considerations such as industry, income, future plans, and more.