

AM ACCOUNTING AND TAX SERVICES LLC

THE S CORPORATION HANDBOOK

A Client's Guide to Federal and Wisconsin S Corporation Requirements

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Welcome

Dear Client,

Congratulations on your S corporation election. This handbook was prepared to give you a clear, practical understanding of what it means to operate as an S corporation — both the advantages the structure offers and the ongoing compliance responsibilities that come with it.

An S corporation is not a “set it and forget it” structure. It requires disciplined payroll practices, careful basis tracking, and attention to deadlines that differ from those you may be used to as a sole proprietor or partnership. The good news is that once these habits are in place, they become routine — and the tax savings and liability protection the structure provides are well worth the extra structure.

Please treat this handbook as a reference, not a substitute for individualized advice. Every business is different, and the specific facts of your situation — your industry, your shareholders, your states of operation — can change how these rules apply to you. We are always available to walk through your specific circumstances.

We are glad to be your partner in this next chapter of your business.

Warm regards,

Alice M. Zaganczyk Peterson, MS, CPA

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Chapter 1 — Understanding the S Corporation

1.1 What an S Election Actually Is

An “S corporation” is not a separate type of legal entity — it is a federal tax election made under Subchapter S of the Internal Revenue Code. The underlying legal entity is still a corporation (or, most commonly for our clients, an LLC that has elected to be taxed as a corporation and then as an S corporation). The election changes how that entity is taxed, not what it is under state law.

Once the election is in effect, the corporation itself generally does not pay federal income tax. Instead, income, deductions, losses, and credits pass through to the shareholders, who report their share on their personal returns — whether or not any cash was actually distributed to them. This “pass-through” treatment is the defining feature of the S corporation and the reason it avoids the double taxation that applies to a traditional C corporation.

PRACTICE NOTE

The most common reason clients choose S status is self-employment tax savings: only the wages paid to a shareholder-employee are subject to Social Security and Medicare tax. Profit distributed beyond reasonable wages is not. Chapter 3 explains why this benefit comes with strings attached.

1.2 Eligibility Requirements

Not every business can elect S status. To qualify, the corporation must meet all of the following at all times:

- Be a domestic corporation (or an LLC that has elected corporate tax treatment) organized in the United States.
- Have no more than 100 shareholders. Members of the same family may generally be treated as a single shareholder for this count.
- Have only eligible shareholders — individuals, certain trusts, and estates. Partnerships, corporations, and non-resident alien individuals may not be shareholders.
- Have only one class of stock. Differences in voting rights are permitted, but all shares must carry identical rights to distributions and liquidation proceeds.
- Not be an ineligible corporation, such as certain financial institutions, insurance companies, or domestic international sales corporations.

If the corporation falls out of compliance with any of these requirements at any point — for example, a share is transferred to an ineligible trust, or a second class of stock is inadvertently created through a disproportionate distribution — the S election can terminate automatically and unintentionally. We monitor for these risks, but you should contact us before any change in ownership, before amending governing documents, or before issuing new equity.

1.3 How an S Corporation Compares to Other Structures

Feature	Details
Sole Proprietorship / Single-Member LLC	All net profit is subject to self-employment tax (15.3% on the first threshold, 2.9% Medicare above it); simplest compliance.
Partnership / Multi-Member LLC	Pass-through taxation; general partners' distributive share is generally subject to self-employment tax; more flexible allocations than an S corp.
S Corporation	Pass-through taxation; only shareholder-employee wages are subject to FICA/Medicare; requires payroll, basis tracking, and a single class of stock.
C Corporation	Entity-level tax on profit, plus a second layer of tax when profits are distributed as dividends; no shareholder limit or eligibility restrictions.

There is no universally “best” structure — the right answer depends on your profit level, your growth plans, and your appetite for administrative complexity. We are glad to revisit this analysis periodically as your business changes.

Chapter 2 — Making (and Protecting) the S Election

2.1 Filing Form 2553

The S election is made by filing Form 2553, Election by a Small Business Corporation, signed by an officer of the corporation and by every person who was a shareholder at any time during the part of the tax year before the election is made. Every shareholder's consent is required — there is no majority-rules provision at the federal level.

Deadline

Form 2553 must generally be filed no later than two months and 15 days after the beginning of the tax year the election is to take effect, or at any time during the preceding tax year. A calendar-year corporation wanting S status effective January 1 must file by March 15 of that year.

Late Election Relief

If the deadline is missed, relief is often still available. Under Revenue Procedure 2013-30, the IRS allows late S elections to be perfected — typically by filing Form 2553 with a reasonable-cause statement attached, provided the corporation has otherwise acted as an S corporation (filed as one, treated shareholders as such, etc.) and the request is filed within three years and 75 days of the intended effective date. We prepare these reasonable-cause statements regularly and can walk you through the documentation needed.

PRACTICE NOTE

Do not assume a missed deadline means the election is lost. In our experience, the large majority of late elections are successfully corrected under Rev. Proc. 2013-30. Contact us as soon as you realize a deadline was missed — the longer the gap, the more documentation is typically needed.

2.2 Form 2553 vs. Form 8832

These two forms serve different purposes and are frequently confused. Form 8832 (Entity Classification Election) is used by an LLC to choose how it is classified for federal tax purposes — as a corporation, rather than its default treatment as a disregarded entity or partnership. Form 2553 is then used to layer the S election on top of that corporate classification. In many cases Form 2553 alone is sufficient for an LLC to be treated as an S corporation, because the IRS treats a timely and valid Form 2553 as including the deemed corporate classification election — but in situations where the effective dates need to differ, or where the classification needs to be established independently, both forms may be filed together.

2.3 Wisconsin Recognition of the Election

Wisconsin does not require a separate state-level S election. A corporation with a valid federal S election is automatically treated as a “tax-option (S) corporation” for Wisconsin purposes unless it affirmatively

opts out by filing Form 5E. Opting out is unusual and generally not advisable without a specific planning reason — we will discuss this with you if it is ever relevant to your situation.

2.4 Ongoing Protection of the Election

Because the eligibility requirements in Section 1.2 must be maintained continuously, we recommend the following safeguards:

- Route every proposed transfer of stock — including transfers to a trust, on death, or in a divorce — through us before it happens.
- Keep distributions strictly proportional to ownership percentage; disproportionate distributions can be treated as a second class of stock.
- Avoid loans or arrangements with shareholders that carry terms resembling equity (deferred, contingent, or subordinated repayment) without review.
- Notify us before admitting any new owner, including through equity compensation or a buy-in arrangement.

Chapter 3 — Reasonable Compensation

3.1 Why the IRS Cares

Because only wages — not distributions — are subject to FICA and Medicare tax, the IRS scrutinizes S corporations for underpaying shareholder-employees in an effort to shift income out of payroll and into distributions. A shareholder who works actively in the business and takes \$0 in wages while taking \$150,000 in distributions is a well-recognized audit target. The IRS and the courts have repeatedly upheld reclassification of distributions as wages — with back payroll tax, penalties, and interest — in these situations.

3.2 What “Reasonable” Means

There is no fixed formula in the Code. Courts and the IRS look at the facts and circumstances, including:

- The training, experience, and duties of the shareholder-employee.
- Time and effort devoted to the business.
- What comparable businesses pay for similar services (third-party compensation data).
- Dividend history, and the proportion of distributions to wages over time.
- Compensation paid to non-shareholder employees for comparable work.

3.3 How We Approach This With You

For each shareholder-employee, we work with you to set a defensible salary level, revisit it annually as duties or profitability change, and document the basis for the figure chosen. We can also reference third-party compensation survey data (such as RCReports or Bureau of Labor Statistics occupational data) to support the position where helpful.

PRACTICE NOTE

A common misconception is that a shareholder can simply take no salary in a loss year. If the shareholder is actively performing services, some level of reasonable compensation is still expected, though the amount can appropriately reflect the company's financial condition.

Chapter 4 — Payroll and Shareholder Health Insurance

4.1 W-2 Wages vs. K-1 Income

A shareholder-employee receives two very different types of income from the corporation, and it is important not to confuse them:

Income Type	Characteristics
W-2 Wages	Compensation for services rendered; subject to federal/state withholding and FICA/Medicare; reported on Form W-2; must be run through a payroll system with the corporation as employer.
Schedule K-1 Income	Pass-through share of the corporation's profit or loss based on stock ownership; not subject to FICA/Medicare or withholding; reported annually regardless of cash distributed.

4.2 Greater-Than-2% Shareholder Health Insurance

A special rule applies to any shareholder who owns more than 2% of the corporation's stock (directly or through attribution). Health insurance premiums the corporation pays on behalf of that shareholder are treated as additional W-2 wages, but they are handled differently from ordinary wages:

- Included in Box 1 (federal taxable wages).
- Excluded from Boxes 3 and 5 (Social Security and Medicare wages) — not subject to FICA/Medicare tax.
- Separately reported in Box 14 with a description such as “2% Shareholder Health Insurance.”

The shareholder may then generally claim a self-employed health insurance deduction on Schedule 1 of their personal return for the same amount, provided the plan is established by the corporation and the shareholder is not eligible to participate in a subsidized plan through another employer (including a spouse's employer). This nets the premium out of taxable income at the individual level while still allowing the corporation to deduct it as a business expense.

PRACTICE NOTE

This add-to-wages treatment must flow through actual payroll — it is not something that can be corrected only on the year-end tax return. If premiums were paid outside of payroll during the year, we need to true this up with your payroll provider before your final payroll run so the W-2 is correct the first time.

4.3 Section 105(h) Nondiscrimination

If the corporation maintains a self-insured medical reimbursement plan (as opposed to a fully insured group policy), Section 105(h) nondiscrimination testing may apply, restricting the extent to which the plan can favor highly compensated individuals. This is less common for our small S corporation clients using standard group policies, but we flag it if it becomes relevant to your plan design.

4.4 Accountable Plans

Reimbursements to shareholder-employees for business expenses paid personally (mileage, home office costs, cell phone, etc.) should be run through a written accountable plan, requiring adequate substantiation and timely reporting. Properly structured, these reimbursements are excluded from wages and deductible by the corporation; without an accountable plan, reimbursements can be treated as additional taxable wages.

Chapter 5 — Shareholder Basis and Loss Limitations

5.1 Stock Basis and Debt Basis

A shareholder can only deduct pass-through losses to the extent of their basis — stock basis plus, in limited circumstances, debt basis from bona fide loans made directly by the shareholder to the corporation (loans guaranteed by a shareholder generally do not create debt basis).

Basis is not a static number — it moves every year:

- Increases: capital contributions, additional stock purchases, and the shareholder's share of income and gain.
- Decreases: distributions, and the shareholder's share of losses, deductions, and nondeductible expenses.

Basis cannot go below zero. Losses that exceed available basis are suspended and carried forward indefinitely until the shareholder generates enough new basis to absorb them — they are not lost, but they are deferred, sometimes for years.

5.2 Form 7203

Shareholders are required to attach Form 7203, S Corporation Shareholder Stock and Debt Basis Limitations, to their personal return in years they receive a distribution, report a loss, dispose of stock, or receive a loan repayment from the corporation. We prepare this form as part of your individual return, but it depends on complete and current basis records — please keep us informed of any capital contributions or shareholder loans during the year as they happen, not at tax time.

5.3 At-Risk and Passive Activity Rules

Basis is only the first hurdle. Losses that clear the basis limitation may still be subject to the at-risk rules (Section 465) and, for shareholders who do not materially participate in the business, the passive activity loss rules (Section 469). These layers apply in sequence — basis first, then at-risk, then passive — and a loss can be stopped at any one of them.

Chapter 6 — Distributions and the AAA

6.1 The Accumulated Adjustments Account

The Accumulated Adjustments Account (AAA) is a corporate-level tracking account (not a shareholder-specific account) that measures the corporation's post-S-election earnings that have already been taxed to shareholders. It generally increases with income and decreases with losses and distributions, and it is reported on Schedule M-2 of Form 1120-S each year.

6.2 Ordering Rules for Distributions

For a corporation that has always been an S corporation (no prior C corporation earnings and profits), distributions are generally tax-free to the extent of the shareholder's stock basis, and any excess is taxed as capital gain. For a corporation with accumulated earnings and profits from a prior life as a C corporation (or from a merger with one), the ordering becomes more layered:

1. Distributed first from AAA — tax-free to the extent of stock basis.
2. Then from accumulated earnings and profits (E&P) — taxable as a dividend.
3. Then from remaining stock basis — tax-free return of capital.
4. Any remainder — taxed as capital gain.

If your corporation has C corporation earnings and profits on its books, this is an area where we pay especially close attention, since it changes how much of a distribution is taxable.

6.3 Distributions Are Not Compensation

A recurring theme throughout this handbook: distributions are a return based on ownership, not a substitute for wages for services performed. See Chapter 3 for the reasonable compensation requirement that governs how much must be paid as W-2 wages before profit is distributed.

Chapter 7 — Federal Filing Requirements and Deadlines

7.1 Form 1120-S and Schedule K-1

The corporation files Form 1120-S annually, reporting income, deductions, and other items, and issues a Schedule K-1 to each shareholder reflecting their share. For a calendar-year corporation, the return (and K-1s) are due by the 15th day of the third month after year-end — March 15 in most years. If Form 7004 is filed by the original deadline, the corporation receives an automatic six-month extension to file, to September 15. An extension to file is not an extension to pay any tax the corporation itself may owe (such as built-in gains tax).

7.2 Shareholder Estimated Taxes

Because no tax is withheld on K-1 income, shareholders are generally responsible for making quarterly estimated tax payments on their share of the corporation's income, using Form 1040-ES. For a calendar-year individual, these are generally due April 15, June 15, September 15, and January 15 of the following year. We incorporate your S corporation income into your personal quarterly estimate calculations as part of our ongoing planning work with you.

7.3 Key Deadlines at a Glance

Item	Deadline (calendar year)
Form 1120-S filing / Schedule K-1 to shareholders	March 15 (16th in 2026, since the 15th falls on a Sunday)
Form 7004 extension request	Same as original filing deadline
Extended Form 1120-S deadline	September 15
Shareholder Form 1040 filing	April 15 (October 15 if extended)
Shareholder quarterly estimates	April 15, June 15, September 15, January 15
Form W-2 to employees / SSA	January 31
Form 941 (quarterly payroll)	April 30, July 31, October 31, January 31
Form 940 (annual FUTA)	January 31

7.4 Penalties for Late Filing

Form 1120-S carries a steep, largely fixed penalty structure because it is an informational return that determines what each shareholder owes. For returns required to be filed in 2026, the penalty is \$255 per shareholder for each month or partial month the return is late, capped at 12 months — and it applies even if the corporation owes no tax. If the return is more than 60 days late, the minimum penalty is the smaller of the tax due or \$525. Failing to furnish a timely, complete Schedule K-1 to a shareholder can trigger an additional, separate penalty.

PRACTICE NOTE

With multiple shareholders, this penalty compounds quickly — a two-shareholder corporation filing three months late faces roughly \$1,500 in penalties alone, with no tax owed. If you think you may miss the March deadline, tell us as early as possible so we can file Form 7004 on time; the extension costs nothing and completely avoids this penalty.

Chapter 8 — Wisconsin State Requirements

8.1 Form 5S

Wisconsin “tax-option (S) corporations” file Form 5S, Wisconsin Tax-Option (S) Corporation Franchise or Income Tax Return, due the same 15th-day-of-the-third-month deadline as the federal return.

Wisconsin provides its own automatic seven-month extension (checking Item B on the form), or recognizes a federal extension by extending the Wisconsin due date to 30 days after the federal extended due date — either way, an extension to file is not an extension to pay.

8.2 The Wisconsin Pass-Through Entity Tax Election

Wisconsin allows an S corporation to elect to pay Wisconsin tax at the entity level, at the state's 7.9% corporate rate, rather than having that income taxed to shareholders individually. This election — commonly called the “PTE” or “SALT cap workaround” election — is popular because the entity-level tax is deductible as a business expense on the federal return, which can reduce the federal impact of the \$10,000 federal cap on individual state and local tax deductions.

Key mechanics of the election:

- Made annually by checking Box 7 on Form 5S — there is no separate election form.
- Requires consent from shareholders holding more than 50% of the corporation's shares.
- Once made for a year, shareholders exclude their share of the entity's income from their own Wisconsin adjusted gross income.
- Certain items are treated differently when the election is made — for example, the corporation (not the shareholders) applies the federal passive-loss and capital-loss rules, and Wisconsin's individual long-term capital gain deduction is not available.

We evaluate this election with you each year as part of your tax planning, since the benefit depends on your specific mix of income, other itemized deductions, and whether you are near the federal SALT cap.

8.3 Business Registration and Ongoing State Filings

Beyond the annual tax return, an S corporation operating in Wisconsin has separate, non-tax compliance obligations:

- Department of Financial Institutions (DFI) Annual Report — required annually to keep the entity in good standing; due during the calendar quarter of your formation anniversary (domestic entities) or by March 31 for foreign entities registered to do business in Wisconsin. The online filing fee is modest (\$25 for a domestic LLC/corporation), but a missed report can eventually lead to administrative dissolution.
- Wisconsin Tax 100 registration with the Department of Revenue for withholding, sales tax (if applicable), and other state tax accounts.

- Wisconsin unemployment insurance (UI) registration with the Department of Workforce Development once the corporation has employees, including shareholder-employees.
- A registered agent with a Wisconsin street address must be maintained at all times.

PRACTICE NOTE

Because Wisconsin does not charge a monetary late fee for a missed DFI Annual Report, it is easy for this filing to be overlooked — there is no bill to prompt action. We recommend calendaring this separately from your tax deadlines, since three consecutive missed years can result in administrative dissolution of the entity.

Chapter 9 — Recordkeeping and Bookkeeping

9.1 Keep Business and Personal Finances Separate

Maintain a dedicated business bank account and credit card, and run all business income and expenses through them. Commingling funds is one of the fastest ways to undermine both clean bookkeeping and the liability protection the corporate structure is meant to provide.

9.2 Monthly Bookkeeping Cadence

- Reconcile bank and credit card accounts monthly.
- Categorize transactions promptly rather than in a year-end batch — this is where basis and loan tracking most often breaks down.
- Track any shareholder loans to or from the corporation separately, with terms documented in writing.
- Retain payroll records, W-2s, 1099s, and Forms 941/940 in an organized, accessible location.

9.3 Record Retention

As a general rule, retain tax returns and supporting records for at least seven years, and retain records related to asset basis (purchase documents, depreciation schedules) for as long as the asset is held plus seven years after disposition. Corporate formation documents, the Form 2553 filing, and shareholder agreements should be retained permanently.

Chapter 10 — Common Pitfalls We See

Paying No (or Too Low) a Salary

The single most common issue we see, and the one most likely to trigger IRS scrutiny. See Chapter 3.

Treating the Corporate Bank Account Like a Personal Account

Frequent personal purchases run through the business account complicate bookkeeping, blur the liability protection, and can create unintended taxable distributions or loans.

Missing the Form 2553 Deadline

Often discovered only when the first tax return is prepared. Usually correctable under late-election relief — but only if caught and addressed promptly.

Disproportionate Distributions

Paying shareholders amounts that are not strictly proportional to ownership — even informally, to cover one owner's personal expense — risks creating a second class of stock and jeopardizing the entire election.

Not Tracking Basis Until a Loss Year

Basis needs to be tracked every year, not reconstructed after the fact when a loss shows up and the shareholder wants to deduct it.

Overlooking the Wisconsin DFI Annual Report

Because there is no monetary late fee to draw attention to a missed filing, this one is easy to let slide until the entity is in delinquent status.

Forgetting Quarterly Estimated Payments

Shareholders accustomed to W-2-only withholding from a prior job are sometimes surprised by an April tax bill and underpayment penalty in their first year of S corporation income.

Chapter 11 — Your Annual Compliance Checklist

When	Task
Ongoing / Monthly	Reconcile bank and credit card accounts; run payroll for shareholder-employees; log any shareholder contributions or loans
January	Issue W-2s and 1099s by January 31; file Form 940; review prior-year reasonable compensation
Quarterly	File Form 941; make shareholder quarterly estimated tax payments (Apr 15 / Jun 15 / Sep 15 / Jan 15)
By formation-anniversary quarter	File Wisconsin DFI Annual Report
March 15	Form 1120-S and Form 55 due (or file extensions); Schedule K-1s issued to shareholders; evaluate the Wisconsin PTE election
April 15	Shareholder Form 1040 due (or extend); first-quarter estimate due
September 15	Extended Form 1120-S / Form 55 due
October 15	Extended shareholder Form 1040 due
Year-round	Contact us before any change in ownership, distributions that are not strictly proportional, or new shareholder loans

A Note on This Handbook

This handbook provides a general overview of S corporation requirements under federal law and Wisconsin state law as of the date of preparation. Tax law changes frequently, and the specific facts of your business can change how these rules apply. This handbook is educational in nature and is not a substitute for advice tailored to your specific situation. Please contact our office before acting on any matter discussed here.

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