



C-Corp to S-Corp

2026 QUICK REFERENCE

• Side by Side • Uneven Earnings • Retirement Limits • Accountant Questions • Deadlines

Pediatric Management Institute

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1 | C-CORP VS. S-CORP AT A GLANCE

Current as of October 2026 • federal rules • state treatment varies

	\$184,500	\$72,000	\$190,000	5 years	March 15
	2026 Social Security wage base — salary above it owes Medicare only	2026 cap on 401(k) + profit sharing per partner, before catch-up	W-2 salary needed to reach the \$72,000 cap, under age 50	built-in gains window after the S election	Form 2553 deadline for a calendar-year election
FEATURE	C-CORP		S-CORP		
TAX AND PAY					
Corporate income tax	21% flat on profit left in the corporation — the reason C-Corp practices pay out profit as compensation		None. Profit passes through to the owners' personal returns		
How partners are paid	All earnings through payroll as salary and bonus		Reasonable W-2 salary through payroll, the rest as distributions		
Payroll tax	On every dollar paid to partners		On salary only — distributions owe no Social Security or Medicare tax		
Year-end pressure	Pay out profit by the last day of the tax year to land near zero net income		No payout deadline — profit is taxed to owners whether or not it leaves the bank		
Unequal partner pay	Easy — production bonuses run through payroll		Distributions must follow ownership %. Extra pay for a high producer runs through payroll		
OWNERSHIP AND BENEFITS					
Classes of stock	Multiple classes allowed		One class only (voting differences allowed)		
Who can own	Unlimited owners, any type		No more than 100; individuals, estates, certain trusts and exempt organizations; no nonresident aliens		
Retirement plan pay base	Full salary and bonus		W-2 salary only — distributions never count		
Owner health insurance	Employer-paid coverage excluded from the partner's income		Over-2% owners: premiums reported as W-2 wages (no FICA); owner may deduct under §162(l)		
CONVERSION ISSUES					
Tax year	Fiscal year allowed		Calendar year unless an exception applies (natural business year, §444, business purpose)		
Prior-year losses	Carry forward against future corporate profit		Losses from C-Corp years generally do not pass through to shareholders		
Appreciated assets	Taxed when sold		21% built-in gains tax if sold or collected within 5 years of the election		

2 | THE DISPROPORTIONATE EARNINGS PROBLEM

Distributions follow ownership • pay in a pediatric group usually follows production

WORKED EXAMPLE • TWO 50/50 PARTNERS IN AN S-CORP

STEP	PARTNER A	PARTNER B
Ownership	50%	50%
Total earned for the year	\$290,000	\$250,000
W-2 salary	\$184,500	\$184,500
Still owed after salary	\$105,500	\$65,500
Pro-rata distribution	\$65,500	\$65,500
Extra paycheck needed	\$40,000	\$0

A 50/50 ownership split means a 50/50 split of every distribution. Partner A's remaining \$40,000 goes out as an extra paycheck, and a paycheck carries payroll tax.

WHAT THE GAP COSTS

- A \$184,500 salary already maxes Social Security, so the extra \$40,000 owes Medicare: 2.9% combined = \$1,160.
- Plus 0.9% Additional Medicare on the partner's wages over \$200,000 (single) or \$250,000 (joint).
- The flip side: with salaries at the wage base, each distribution dollar saves only Medicare, 2.9% to 3.8%. A \$65,500 distribution saves about \$1,900.
- The wider the gap, the bigger the drift. Every dollar paid as salary instead of distribution gives back the saving.
- Paid in January instead? Social Security is withheld until the new year's wage base is hit again, so the yearly total stays capped. Net extra cost is still Medicare.

TRAP • EAT-WHAT-YOU-KILL GROUPS

- Production formulas create the widest gaps and feel the drift most.
- Two or three partners \$40,000+ above the rest see less benefit than everyone else.
- Never pay distributions out of proportion to ownership to "fix" the gap. Uneven distributions invite an IRS question about a second class of stock.

3 | RETIREMENT CONTRIBUTIONS — THE COST OF A LOW SALARY

MOST OFTEN MISSED

2026 IRS limits • one partner earning \$300,000, under age 50

2026 PLAN LIMITS

- \$24,500 employee 401(k) deferral.
- \$8,000 catch-up at age 50+, on top of the cap.
- \$72,000 total per partner, all sources, before catch-up.
- 25% of W-2 pay — the employer profit-sharing deduction limit.
- Distributions never count as plan compensation. Cash balance plans also key off salary.

2026 PAYROLL TAX RATES

TAX	RATE (EMPLOYER + EMPLOYEE)
Social Security	12.4% up to \$184,500
Medicare	2.9% on all wages
Additional Medicare	0.9% employee, over \$200K single / \$250K joint

SALARY CHOICE • PAYROLL TAX SAVED VS. RETIREMENT ROOM LOST

W-2 SALARY	DISTRIB.	PAYROLL TAX*	TAX SAVED	MAX PLAN**	SHORTFALL
\$300,000 (C)	—	\$31,578	—	\$72,000	\$0
\$200,000	\$100,000	\$28,678	\$2,900	\$72,000	\$0
\$190,000	\$110,000	\$28,388	\$3,190	\$72,000	\$0
\$150,000	\$150,000	\$22,950	\$8,628	\$62,000	\$10,000
\$120,000	\$180,000	\$18,360	\$13,218	\$54,500	\$17,500

*Employer + employee Social Security (12.4% to \$184,500) and Medicare (2.9%); excludes 0.9% Additional Medicare. **\$24,500 deferral + profit sharing at 25% of salary, capped at \$72,000. Shortfall dollars are taxed now instead of growing tax-deferred, every year.

TRAP • SALARY SET FOR TAX ALONE

- The IRS requires reasonable compensation before any distribution, and can reclassify distributions as wages.
- A physician's revenue comes from personal services — the IRS test for what counts as wages.
- A low salary also shrinks the 401(k) and cash balance room partners in their 50s and 60s need most.
- Salary below \$184,500 earns less Social Security credit. Benefits use the highest 35 years, so a few low years trim the benefit modestly. Set aside part of each distribution.

Read the table: dropping salary from \$300,000 to \$120,000 saves \$13,218 in payroll tax but cuts the retirement maximum by \$17,500 a year. Assumes profit sharing at 25% of the partner's own salary; plan design changes the math, so run it with your plan administrator.

4 | THREE QUESTIONS FOR YOUR ACCOUNTANT

Get written answers before anyone files · in PMI's experience, about 30% of switches carry no tax impact

1 · WHAT DOES THE ENTITY CHANGE COST US IN TAX?

- **An election, not a dissolution.** The corporation stays intact and files Form 2553.
- **Built-in gains tax.** Assets worth more than their tax basis on the election date owe 21% corporate tax if sold or collected within 5 years.
- **Net test.** The tax applies only when total built-in gains exceed total built-in losses.
- **Ask for a dollar estimate,** not a yes or no.

2 · WHAT HAPPENS TO OUR ACCUMULATED CARRY-FORWARD LOSSES?

- **Use those exact words.** Corporate net losses carry forward against future corporate profit.
- **C-Corps run to zero** often pile up losses in the hundreds of thousands of dollars.
- **Real value:** at the 21% corporate rate, a \$100,000 loss is worth **\$21,000**. Losses from 2018 on offset up to 80% of a year's taxable income.
- **Generally lost to shareholders** after an S election. Check last year's return, then ask whether any can still be used, e.g. against built-in gains tax.

3 · HOW WOULD LAST YEAR HAVE SHAKEN OUT AS AN S-CORP?

- **Rerun the last full year** with real partner earnings.
- **Use a defensible reasonable salary** for each partner and pro-rata distributions.
- **Net the payroll tax saved** against the disproportionate-earnings drift, built-in gains exposure, lost carry-forward losses and the retirement shortfall.
- **The answer** says whether the S-Corp wins, and by how much.

DOCUMENT ON THE ELECTION DATE	WHY IT MATTERS	WHAT TO RECORD
Equipment and furniture	Depreciated tax basis often sits below market value — a sale within 5 years can trigger built-in gains tax	Fair market value and adjusted tax basis, by asset
Real estate the corporation owns	Usually the largest built-in gain for a practice that owns its building	Appraised value and tax basis
Goodwill and patient base	Valued in any sale or merger inside the 5-year window	Valuation as of the election date
Receivables not yet taxed	Collections within 5 years can count as built-in income	Receivables balance on the election date
Retained earnings from C-Corp years	Distributed after the election, these are taxed as dividends	Accumulated earnings and profits balance

Without a record, the IRS may treat the whole later gain as built-in. Have your CPA prepare the schedule at the conversion, not after a sale.

5 | DEADLINES AND FILINGS

IRS Form 2553 instructions · every shareholder signs

FORM 2553 TIMING

ITEM	RULE
File by	No more than 2 months and 15 days after the start of the tax year the election takes effect, or any time in the prior year
Calendar year	March 15
Filed late	Generally takes effect the following year
Late relief	Rev. Proc. 2013-30 — reasonable cause, generally within 3 years and 75 days of the effective date

ELIGIBILITY CHECKLIST

- **No more than 100 shareholders;** spouses count as one.
- **Eligible owners:** individuals, estates, certain trusts and exempt organizations.
- **No nonresident alien** shareholders.
- **One class of stock.**
- **Every shareholder consents** on the form; spouses with a community interest both sign.

TAX YEAR AND STATE

- **Calendar year by default.** Alternatives: natural business year, §444 election, or business purpose (IRS user fee).
- **Non-calendar practices** face a short tax year in the conversion — a second change on top of the election.
- **Most states follow the federal election.** New York needs its own (Form CT-6), or the practice stays a C-Corp for New York tax.
- **Some places tax S-Corps anyway:** California's 1.5% franchise tax, New York City's corporate tax.

6 | DECISION GUIDE | CONVERSION CHECKLIST

Model first, elect second · PMI is glad to join the accountant call

THE S-CORP TENDS TO WIN WHEN

- **Partners earn close to the same amount.**
- **The practice wants to hold cash** past year-end without a payout rush.
- **The model shows little built-in gain** and few carry-forward losses to forfeit.
- **Reasonable salaries still leave room** to max out retirement plans.

STAYING A C-CORP TENDS TO WIN WHEN

- **The practice already lands at zero net income** every year.
- **Earnings vary widely** across partners or the formula is eat-what-you-kill.
- **The corporate return shows large carry-forward losses.**
- **Partners max out retirement plans** and need salaries of \$190,000+ anyway.

NEVER

- **File Form 2553** before the accountant puts a dollar figure on the switch.
- **Set salaries** to minimize payroll tax alone.
- **Pay distributions** out of proportion to ownership.
- **Assume your state** follows the federal election.

1 · MODEL LAST YEAR

Accountant reruns the last full year as an S-Corp with real partner earnings and pro-rata distributions.

2 · PRICE THE CONVERSION

Dollar estimate for built-in gains exposure and any carry-forward losses the practice would give up.

3 · SET DEFENSIBLE SALARIES

Reasonable compensation for each partner, checked against the retirement plan maximums.

4 · DOCUMENT ASSET VALUES

Fair market value and tax basis of every asset, as of the election date, kept with the tax file.

5 · FILE FORM 2553

Every shareholder signs. Due within 2 months and 15 days of the tax year it covers.

6 · FILE THE STATE ELECTION

Where the state requires one, such as New York's Form CT-6.

7 · SETTLE THE TAX YEAR

Move to a calendar year, or document the exception the practice qualifies for.

8 · UPDATE PAYROLL

Over-2% owners' health premiums go on the W-2; salaries and distribution dates set for the year.

- **Form 2553** — The IRS election that makes an existing corporation an S-Corp. Every shareholder signs.
- **Reasonable compensation** — Wages an S-Corp must pay a shareholder-employee for services before any distribution.
- **Distribution** — S-Corp profit paid to owners in proportion to ownership. No Social Security or Medicare tax.

- **Pro rata** — In proportion to ownership percentage. The only way S-Corp distributions can be split.
- **Wage base** — The \$184,500 ceiling on 2026 wages subject to Social Security tax. Medicare has no ceiling.
- **415(c) limit** — The \$72,000 2026 cap on all contributions to a partner's 401(k) and profit-sharing accounts.

- **Built-in gains tax** — 21% corporate tax on appreciation that existed at the election, recognized within 5 years.
- **Carry-forward loss** — A prior-year corporate loss applied against future corporate profit. Generally lost after the switch.
- **Accumulated E&P** — Earnings from C-Corp years. Taxed as dividends when distributed after the election.

- **Over-2% shareholder** — An S-Corp owner whose health premiums are reported as W-2 wages.
- **One class of stock** — Every share carries identical distribution and liquidation rights. Voting may differ.
- **§444 election** — Lets an S-Corp keep a non-calendar tax year, subject to IRS rules.

PMI'S BOTTOM LINE

An S election is often good advice, but the payoff for a pediatric group is often smaller than the pitch. When the practice already lands at zero net income, partners earn different amounts, and salaries sit above the Social Security wage base, the payroll tax saving shrinks to Medicare alone. Bring your accountant the three questions above and run the retirement numbers next to the tax savings before anyone signs.