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COVID-19: Tax Benefits for S Corporation Owners

To help your small business, Congress created a lot of new tax-saving provisions due to the COVID-19 pandemic.

Many of you own and operate S corporations and expect the tax law to treat you differently, as it does with your health insurance deduction.

You've been asking us to help clarify which of the COVID-19 tax benefits the S corporation owner can use to put cash in his or her pocket.

We'll go over the most important COVID-19 tax provisions and tell you what we know about how they apply to you.

Payroll Tax Deferral

You can defer payment of your S corporation's employer share of Social Security tax on federal tax deposits you would otherwise have to make during the period beginning on March 27, 2020, and ending December 31, 2020.[1]

Your S corporation's deferred Social Security taxes are due in two installments. You must pay 50 percent by December 31, 2021, and the other 50 percent by December 31, 2022.[2]

If you are an S corporation owner, the S corporation can defer the employer portion of Social Security tax on your salary just as it can on any other employee.

PPP Exception

If your S corporation receives a Paycheck Protection Program (PPP) loan, and it obtains loan forgiveness, it does not qualify for the payroll tax deferral provision.

PPP exception loophole. The PPP loan forgiveness prohibition doesn't apply until your S corporation receives a decision from your lender on PPP loan forgiveness. Before that date, you can defer payroll taxes even if you apply for and receive a PPP loan.[3]

Example 1. You operate as an S corporation and have three employees, including yourself. Your S corporation's April payroll is $10,000, including your W-2 salary or wages.

The employer Social Security tax on this payroll is $620. Your S corporation doesn't have to pay it with its federal tax deposit. Instead, it will pay $310 by December 31, 2021, and the other $310 by December 31, 2022.

Employee Retention Credit

Your S corporation gets a refundable payroll tax credit against the employer share of employment taxes equal to 50 percent of its wages paid to employees after March 12, 2020, and before January 1, 2021.[4]

We review the rules for this tax credit in COVID-19: Significant Payroll and Self-Employment Tax Relief.

But the law also states that "rules similar to the rules of sections 51(i)(1) and 280C(a) . . . shall apply."

Code Section 280C(a) states you can't deduct wage expenses equal to the employee retention credit you receive—no double dipping.

Code Section 51(i)(1) affects the S corporation shareholder by denying the employee retention credit for wages paid to the following family members of a 50-percent-or-more shareholder:[5]

- A child or a descendant of a child
- A brother, sister, stepbrother, or stepsister
- The father or mother, or an ancestor of either
- A stepfather or stepmother
- A son or daughter of a brother or sister of the taxpayer

A brother or sister of the father or mother of the taxpayer

- A son-in-law, daughter-in-law, father-in-law, mother-in-law, brother-in-law, or sister-in-law
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The provision does not prevent the S corporation owner from taking the employee retention credit on his or her wages, provided that the S corporation otherwise meets one of the following requirements:

- A government order fully or partially suspended your operations during a calendar quarter due to COVID-19.
- Your calendar-quarter gross receipts are less than 50 percent of gross receipts from the same quarter in the prior year.

PPP Exception. If you receive a PPP loan, then you don't qualify for the employee retention credit.

Example 2. ABC Corporation is an S corporation with four equal owners who each own 25 percent. It has eight employees: the four owners and four children of the owners. A government order partially suspended the business operations. Because no shareholder has 50 percent or more ownership, the wages of all eight employees qualify for the employee retention credit.

Example 3. DEF Corporation is an S corporation that is 100 percent owned by a married couple. It has four employees: the two owners and two children of the owners. A government order partially suspended the business operations. Only the wages of the two owners qualify for the employee retention credit.

Tax-Free Disaster Payments

As we discussed in Tax Loophole Allows Tax-Free COVID-19 Payments to Employees, Congress allows your S corporation to make tax-deductible disaster-related payments to its employees, and those payments are tax-free to its employees.[6]

But as you likely know, S corporation owners usually can't take advantage of tax-free fringe benefits, and usually have to include their value as taxable income on their W-2.[7] Be sure to read S Corporation Fringe Benefits after the Recent Tax Reform to learn all the details.

We have good news about disaster-related payments: none of the guidance issued about these payments denies their favorable tax treatment to the S corporation shareholder. In addition, the IRS doesn't mention such payments in Publication 15-B, *Employer's Tax Guide to Fringe Benefits*.[8]

But we have some bad news, too—there is no guidance explicitly allowing the S corporation owner to take advantage of the tax-free disaster-related payments.

If you choose to have your S corporation provide tax-free disaster-related payments to you, we recommend you implement a formal, written plan and keep excellent documentation—even though such steps are not required by the law.

Example 4. Your S corporation sets up a plan to give every employee a $500 payment to cover telework supplies and ongoing expenses during the COVID-19 pandemic. Your business is subject to a shutdown order, and all 12 of your employees, including you, must work remotely from home.

The $6,000 in payments your S corporation provides is tax-deductible to the corporation and tax-free to the employees, including the S corporation shareholder.

Takeaways

Many small-business owners, like you, operate out of an S corporation. And as you know, the tax law sometimes isn't kind to S corporation owners, because the law limits or eliminates tax breaks other business owners can take.

Luckily for you, S corporation owners get to benefit from most of the big COVID-19 tax benefits, including:

- Payroll tax deferral
- Employee retention credit
- Tax-free disaster-related payments

But be alert to the following hiccups:

- You can't defer your share of payroll taxes once your lender has notified you of PPP loan forgiveness.
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You can't use the employee retention credit if you receive a PPP loan. And if you qualify for the credit, and you own 50 percent or more of the corporation, you can't take a credit for wages paid to many of your family-member employees.

- There's no official guidance allowing tax-free disaster payments to S corporation owners, but there's also nothing stating that the owners can't benefit. So, make the payments on the up-and-up with good records.

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1 CARES Act, Section 2302; FAQs 1 and 2, IRS Deferral of employment tax deposits and payments.
2 Ibid.
3 FAQ 4, IRS Deferral of employment tax deposits and payments.
4 CARES Act, Section 2301.
5 IRC Section 51(i)(1)(A); IRC Section 152(d)(2).
6 IRC Section 139.
7 IRC Section 1372; Rev. Rul. 91-26.
8 Publication 15-B, Employer's Tax Guide to Fringe Benefits (2020), dated Dec. 26, 2019.