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New Five Year Rule Provides Built-In Gains Relief to S Corporations

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From 1986 until very recently, a C corporation that converted to an S corporation faced potential double taxation on built-in gain assets ("BIG assets") for a 10 year period following its S election. The full benefit of electing S corporation status and pass-through taxation was only available after the 10 year period.

In 2009, legislation was enacted reducing the built-in gain period to seven years for BIG assets sold in 2009 and 2010. In the recently-enacted Small Business Jobs Act of 2010, this period was reduced to five years for BIG assets sold in 2011.

This generally means that if a corporation's S election was on January 1, 2006 or earlier, there will be no corporate level tax on BIG assets sold in 2011.

Unless it is extended, this provision only is valid for this year and the law will revert to the 10 year built-in gains period at the end of 2011. Owners of S corporations with significant built-in gains should consider the tax benefits of selling BIG assets during this time frame.

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