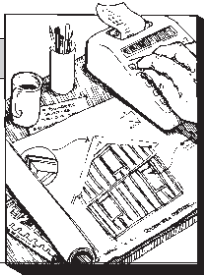


# Why We Went Sub-S

by Andrea Morgante



"President of the corporation" is certainly not a title I could have imagined 12 years ago. I had just completed a graduate program in landscape design, moved to Vermont, and was anxious to learn the construction aspect of landscaping. Within a year I found myself working with three other landscapers, informally collaborating on design/build jobs. We talked about formalizing the work arrangement, but mostly we just got jobs, hired each other, got paid, and started the process all over again. This changed when we learned that an older

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contractor in the area was ready to retire. We bought his client list, and that was the impetus we needed to get our act together and make a commitment to one another.

Among the four of us, we had a variety of tools, skills, trucks, jobs in progress, education, and cash. We also had a great deal of trust in each other and the overwhelming desire to just get out and landscape. At the time we were fortunate to have as a client an understanding lawyer, who advised us to form a subchapter S corporation, often abbreviated to "sub S". It was a hot afternoon in July when we crowded into the lawyer's office and entered the corporate world.

## Why Subchapter S?

According to the Small Business Association (SBA), the purpose of selecting status as a sub S corporation is to permit a small business corporation "to have its income taxed to shareholders as if the corporation were a partnership. One objective is to overcome the double tax feature of our system of taxing corporate income and stockholders' dividends. Another purpose is to permit the shareholders to have the benefit of offsetting business losses incurred by the corporation against the income of the shareholders.

"Among the conditions for the making and maintenance of subchapter S election are that the corporation have ten or fewer shareholders, all of whom are individuals or estates, that there be no non-resident alien shareholders, that there be only one class of outstanding stock, that all shareholders consent to the election, and that a specific portion of the corporation's receipts be derived from active business rather than enumerated passive investments. No limit is placed on the size of the corporation's income and assets."

(from "Selecting the Legal Structure for Your Firm," SBA Management Aids #6.004. SBA is located at 1111 18th St. NW, 6th Flr., Washington D.C. 20416; 202-653-6600.)

In practical terms the sub S corporation allowed us to create a business where we were shareholders, officers, and employees. We wrote articles of association that defined our type of business. We kept the language general enough so that we have been able to expand our scope of services over the past 12 years without changing those basic principles. Each year we hold an annual meeting, elect ourselves officers, file a one-page form with the Secretary of State and pay a filing fee of \$75. We hire ourselves and are paid a salary. Profits and losses based on shares are taxed to each of us as individuals.

Being employees has made us eligible for workers compensation. Starting out, this was a valuable benefit, since we had to pay it anyway and couldn't afford additional health insurance. The first few winter seasons were during an economic recession, and work was very scarce, but as employees we were eligible to collect unemployment compensation.

In setting up the corporation we elected to have our fiscal year end in February. This allows us the winter months to catch up on our bookkeeping. It also gives us a chance to evaluate our financial picture and make decisions on business purchases and the tax ramifications at our slow time of year.

## Twelve Years Later

Over the years the business has changed from our original four officer shareholder/employees; we now have two officer/shareholder/employees, and ten employees. Fortunately at the time of incorporation we had anticipated the possibility of change and had drafted a buy-out agreement. This allowed for the shares to be bought back by the corporation, without having to raise an unreasonable amount of capital immediately.

Our employees have become our most valuable asset. As time goes on we hope to transfer shares to some of our key employees and share the profits in this way. We don't expect huge dividends and often will actually invest all profits back into the business. We have taken out a few loans on vehicles but have tried to keep the growth rate of the business within our financial capabilities.

Throughout this growth the advice from our bookkeeper and accountant has been crucial. It took several years to understand the financial aspects of our business. We have now worked out a good arrangement for salary, wages, and dividends, and we have the benefit of favorable tax treatment (we are taxed only once, as individuals).

In addition to our financial

advisors, professional legal advice has been helpful through the years. We've learned to ask specific questions, as lengthy discussion becomes very expensive. But setting up and running a sub S corporation is simple enough and doesn't require that much professional input. Where time should not be spared, however, is in discussion with potential shareholders. Discussion and more discussion helps establish whether a long-term relationship will work.

What we wanted when we started was to actively participate in a landscape design/build business, and sub S election has helped us to do that. Today we are paid a reasonable salary, enjoy benefits such as health insurance, a pension plan, occasional business lunches and dinners, and lots of plants and equipment to use in our own yards. ■

*Andrea Morgante is co-owner of Siteworks, Inc., a landscape design/build business in Hinesburg, Vt.*