



C-Corporation versus S-Corporation

Authored by Chris Darst
Vice President, 949-234-9648

In deciding between a C-corporation and an S-corporation for your agency's corporate tax structure, with only a few exceptions, we usually recommend that agency owners file for S-corporation status (limited liability corporations and general partnerships have the same tax affect).

As discussed in the June 2010 Dealmaker's Dialogue, from an acquisition perspective, most buyers prefer to purchase the assets of an agency, not the stock. A C-corporation must sell stock. If it sells assets, it will incur "double tax" - once at the corporate level and once at the shareholder level. An S-corporation that survives the Built-in Gains period can sell assets or stock, and in both cases would only be taxed once at the shareholder level (capital gains tax). The chart below illustrates the fundamental differences between a stock deal and asset deal from both a buyer's and seller's perspective.

Many agency owners understand the benefits of being an S-corporation when it comes to selling the agency, but are hesitant to convert to an S-corporation because of misconceptions from an operating point of view. One misconception is that the election will alter the legal status of the corporation to that of a partnership and each shareholder will have unlimited liability for the acts of the corporation. The election of S-corporation status does not change the legal structure of the organization; it is merely a tax option. A second misconception is that the transfer of responsibility for the payment of taxes on the corporate income to individual shareholders creates a cash need that otherwise would not have existed. This simply is not true. There is no increased cash need between operating an S-corporation and C-corporation. The agency distributes the necessary funds to pay taxes to the shareholders on a tax-free basis. A third misconception is if an agency does not plan to pay dividends, C-corporation status is more favorable. This could be true if the agency's corporate tax rate is significantly lower than the individual shareholder's personal income tax rates, but probably unlikely for most agencies.

Buyer's Perspective	
C-Corp (Stock Deal)	S-Corp (Asset Deal)
Would prefer to purchase assets, but probably have to purchase stock	Can purchase assets (or stock)
Will not receive tax amortization	Will receive 15 year tax amortization
Purchases entire corporation, including known and unknown liabilities	Purchases book of business and operating assets/liabilities, corporation and most liabilities stay with corporation (seller)
Lower return on investment	Higher returns on investment
More risk	Less risk
Lower price	Higher price

Seller's Perspective	
C-Corp (Stock Deal)	S-Corp (Asset Deal)
Must sell stock (if assets are sold - would get double taxed)	Can sell assets (or stock)
Subject to capital gains tax	Subject to capital gains tax
Sells entire corporation, including known and unknown liabilities	Sells book of business and operating assets/liabilities, corporation and most liabilities stay with corporation (seller)
Fewer buyers interested	More buyers interested
Less risk	More risk
Lower price	Higher price

S-corporation status provides several benefits from an operating perspective. Losses incurred by an S-corporation can be reported on the shareholder's personal income tax return, thereby reducing their personal income tax liability. In contrast, losses incurred by a C-corporation carry forward to offset future profits of the agency. Additionally, distributions to shareholders of an S-corporation can be made at any time during the year and are not subject to payroll taxes as in the case of bonuses. This can be a nice benefit when trying to perpetuate the agency.

Regardless of your plans, S corporations should be aware of an important provision included in The Small Jobs Act signed into law on September 27, 2010. Prior to 2009, an S-corporation needed to elect S status at least 10 years prior to a sale to eliminate the Built-in Gains tax. This period was reduced to 7 years in 2009 and 2010. The new law reduces the holding period to 5 years for the 2011 tax year only.

From an operating perspective, the differences of a C-corporation and an S-corporation are negligible. However, S-corporations provide significant advantages in the event of a sale. While a firm may not be considering a sale, being structured in the best way possible provides the company with the flexibility to perpetuate internally or externally at the best possible price.

MarshBerry M&A Advisory Services

Deal Strategy

1. Acquisition Planning
2. Deal Return Modeling
3. Strategic Options Analysis
4. Alternative Buyer Comparison

Deal Preparation

1. Sale Preparation Management
2. Offering Memorandum Development
3. Strategic Pitch Book Design
4. Candidate Profile Creation

Deal Representation

1. Buy Side Representation
2. Sell Side Representation
3. Letter of Intent Development / Negotiation
4. Creative Deal Structure Alternatives

Deal Analysis

1. Agency Fair Market Valuation
2. Market Comparables / Deal Benchmarking
3. After-Tax Return Optimization
4. IRR, ROI and EPS Analysis

Deal Execution

1. Diagnostic and Confirmatory Due Diligence
2. Intangible Asset Allocation - GAAP Reporting
3. Fairness Opinion
4. Definitive Agreement Best Terms / Conditions

Post-Deal Management

1. Post-Closing Integration
2. Goodwill Impairment Testing
3. Peer-to-Peer CEO Exchange
4. Earn-Out Maximum Consultation

SNL Financial M&A Advisor Rankings

Insurance Broker Merger & Acquisition Deals
1997-2009

Rank	Firm	1997 - 2009 # of Deals	2009 # of Deals
1	Marsh Berry & Co. Inc.*	275	23
2	Hales & Co. Inc.	123	14
3	Reagan Consulting Inc.	113	7
4	Mystic Capital Advisors Group, LLC	95	11
5	Macquarie Capital Advisors Group, LLC	44	8
6	Bank of America Merrill Lynch	22	2
7	B.H. Burke & Co., Inc.	16	0
7	Harbor Capital Advisors, Inc.	16	0
9	Keefe Bruyette & Woods, Inc.	15	0
9	Sica Consultants, Inc.	15	3
11	North Bridge Advisors, Inc.	13	0
11	Sandler O'Neill & Partners, L.P.	13	1
13	Philo Smith & Co.	10	0
14	Credit Suisse (USA) Inc.	9	0
15	Business Management Group, Inc.	8	0
15	Curtis Financial Group, LLC	8	0
15	J.P. Morgan Securities, Inc.	8	0
18	Boenning & Scattergood, Inc.	7	0
18	Gill and Roeser Holdings, Inc.	7	0
18	Nexus Group, Inc.	7	0
21	2nd Generation Capital Corporation	6	0
21	Garland McPherson & Associates, Inc.	6	0
21	Goldman, Sachs & Co.	6	0
24	Lazard Freres & Co. LLC	5	0
24	Wells Fargo Securities, LLC	5	0
26	Austin Associates, LLC	4	0
26	Nomura Securities International, Inc.	4	0
26	Piper Jaffray & Co.	4	1
26	Russell Miller Corporate Finance, Inc.	4	0
26	UBS Investment Bank	4	0

All States // Completed Transactions
Whole deals as reported by SNL Financial, January 15, 2010

*** MarshBerry has closed 28% of total deal flow since 1997**

MarshBerry's clients are committed to realizing their fullest potential with respect to growth, profit, survival and shareholder value. Our agent, broker, bank and carrier clientele engage us to achieve their goals within the retail and wholesale channels of the insurance distribution system. Our unparalleled industry-specific services include consulting, performance benchmarking, peer-to-peer exchange networks, merger and acquisition intermediation and producer recruiting.