

**“Winning Business Strategies”  
Webinar Series**



# What’s the right business entity choice?

Presented by:

Michael E. Stover, CPA/ABV & Michael P. Moloney, JD, CFP®



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## Entity Choices

- C Corporation
- S Corporation
- LLC
- Partnership
- Sole Proprietorship



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## State Law vs. Federal Law

- State Law
  - Determined by filing with Secretary of State
  - Supplies rules of corporate governance
  - Determines creditor’s rights
- Federal Income Tax Law
  - Selected on SS4 form by checking the box
  - Determines income tax rules



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## Liability Issues

- What creditor protection does each form offer?
  - From the bank
  - From the landlord
  - From creditors of the entity

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## Restrictions on Ownership

Corporation	Partnership / LLC	S Corporation
No restrictions	No restrictions	<ul style="list-style-type: none"> <li>– Must be limited to 100 shareholders</li> <li>– Can only be certain kinds of trusts</li> <li>– Cannot be an entity with multiple owners</li> </ul>

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## Operational Tax Issues

- Income tax
- Employment tax
- Deductibility of Fringe benefits

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## Income Tax Issues

Corporation	Partnership / LLC	S Corporation
<p>Corporation is taxed on its income using its own set of graduated tax brackets.</p> <p>\$ 0 - \$ 50,000 = 15%                      \$ 50 - \$ 75,000 = 25%                      \$ 75 - \$100,000 = 34%                      \$100 - \$335,000 = 39%                      &gt; \$335,000 = 34%</p>	<p>Partners taxed on their share of income, regardless of distributions. Losses may be deducted by partners to the extent of basis. Share of liabilities increase basis of GPs.</p> <p>Allocation is determined by Agreement if "substantial economic effect".</p>	<p>Shareholders taxed on their share of income, regardless of distributions. Losses may be deducted by shareholders to extent of basis.</p> <p>Allocation is determined by interest owned on a daily basis.</p>

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## Employment Tax Issues

Corporation	Partnership / LLC	S Corporation
<p>Officers are paid a salary which is subject to employment taxes.</p> <p>Dividends of retained earnings are subject to income tax at shareholder level. (double taxation)</p>	<p>Partners are not employees, amounts paid are considered a distribution of earnings, unless they qualify as a guaranteed payment. Self-employment tax on general partner's share of income.</p> <p>No additional tax on distributions.</p>	<p>Officers are paid a salary which is subject to employment taxes.</p> <p>Dividends of retained earnings are NOT subject to income tax at shareholder level.</p>

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## Fringe Benefits

Corporation	Partnership / LLC	S Corporation
<p>Available to all shareholders who are employees. Cannot be discriminatory in favor of highly compensated employees.</p>	<p>Partners are required to include value of fringe benefits in gross income.</p> <p>(For example, not allowed to participate in Sec. 125 plans)</p>	<p>Shareholders owning 2% or more are required to include value of fringe benefits in gross income.</p> <p>(For example, not allowed to participate in Sec. 125 plans)</p>

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## Estate Planning Issues

Corporation	Partnership / LLC	S Corporation
<ul style="list-style-type: none"> <li>- Freely transferable</li> <li>- Dividends to owners</li> </ul>	<ul style="list-style-type: none"> <li>- Freely transferable</li> <li>- Income distributions to owners</li> <li>- Income tax basis step-up on internal assets</li> </ul>	<ul style="list-style-type: none"> <li>- Restrictions on transfers</li> <li>- Income distributions to owners</li> <li>- Only one class of stock</li> </ul>

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## Distributions of Property

Corporation	Partnership / LLC	S Corporation
<p>Corporation required to recognize gain as if it sold the property.</p> <p>Value is the taxed to shareholder as a dividend. (double taxation)</p>	<p>No gain or loss to the partnership or partner unless Sec. 751 applies. Partner assumes partnership's basis in property.</p>	<p>Same as corporation. Gain is allocated to shareholders. Distributions must be proportionate to all shareholders.</p>

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## Sale of Stock or Assets

Corporation	Partnership / LLC	S Corporation
<p>Capital gain treatment on sale of stock. 50% of gain can be excluded from income. \$50,000 (\$100,000 if filing joint) of loss can be deducted against ordinary income.</p> <p>Sale of assets taxed to corporation, then liquidating dividend taxed to shareholders.</p>	<p>Capital gain treatment unless Sec. 751 applies.</p>	<p>Capital gain treatment on sale of stock. Small business stock exclusion/deduction does not apply.</p> <p>Gain on sale of assets allocated to shareholders, which increases basis, which reduces gain upon liquidation.</p>

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## Changing From One Form to Another

- C Corporation to S Corporation
- S Corporation to LLC
- LLC to S or C Corporation

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## Review Pros and Cons

- C Corporation
- S Corporation
- LLC
- Partnership
- Sole Proprietorship

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## What's the right business entity choice?

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