CHOICE OF ENTITY

THE TAX DECISION

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Adapted by MA Small Business Development Center
WHAT ARE THE CHOICES?

- Sole proprietorship
- Partnership
- Corporation
- Limited liability company or LLP
KEY BUSINESS ISSUES

- OPERATIONS
- HOLDING ASSETS
- STAYING SMALL
- GOING PUBLIC
- ACCESSING CAPITAL
KEY DIFFERENTIATORS

- PERSONAL LIABILITY PROTECTION
- TAX ADVANTAGES
- COST
- SIMPLICITY
SOLE PROPRIETORSHIP

ADVANTAGES

1. SIMPLE, NO SEPARATE FILING
2. NO STATE FILINGS
3. LOSSES PASS THROUGH
SOLE PROPRIETORSHIP

- **DISADVANTAGES**
  1. PERSONAL LIABILITY
  2. LIMITED ACCESS TO CAPITAL
  3. SELF EMPLOYMENT TAX
GENERAL PARTNERSHIP

● ADVANTAGES

1. SINGLE LEVEL OF TAXATION
2. LOSSES PASS THROUGH
3. SIMPLE ADMINISTRATION
GENERAL PARTNERSHIP

- DISADVANTAGES
  1. PERSONAL LIABILITY
  2. LIABILITY FOR PARTNER’S COMMITMENTS
  3. LIMITED ACCESS TO CAPITAL
CORPORATION

- ADVANTAGES
  1. LIMITED LIABILITY
  2. ACCESS TO CAPITAL
  3. OWNER BENEFITS DEDUCTIBLE
  4. LESS PAYROLL TAXES
CORPORATION

• DISADVANTAGES
  1. DOUBLE LAYER OF TAXATION
  2. TAX ON EXCESS RETAINED EARNINGS
  3. PRORATA EARNINGS DISTRIBUTION
  4. MORE ADMINISTRATION
  5. STATE FILINGS REQUIRED
SUBCHAPTER “S” CORPORATION

ADVANTAGES

1. ONE LEVEL OF TAX
2. LIMITED LIABILITY
3. LESS PAYROLL TAXES
4. LOSSES PASS THROUGH (UP TO ‘BASIS’)
SUBCHAPTER “S” CORPORATION

- DISADVANTAGES
  1. LOTS OF RULES
  2. ONE CLASS OF OWNERSHIP
  3. NEED “BASIS” FOR LOSSES
  4. PRORATA DISTRIBUTIONS
  5. LIMITED ACCESS TO CAPITAL
  6. STATE FILINGS REQUIRED
LIMITED LIABILITY COMPANY LLC
LIMITED LIABILITY PARTNERSHIP LLP

ADVANTAGES

1. SINGLE LEVEL OF TAXATION
2. LOSSES PASS THROUGH
3. LIMITED LIABILITY
4. ADMINISTRATION BY AGREEMENT
5. BROADER OWNERSHIP ALLOWED
LIMITED LIABILITY COMPANY LLC
LIMITED LIABILITY PARTNERSHIP LLP

● DISADVANTAGES
  – SELF EMPLOYMENT TAX
  – NEW TYPE ENTITY, NOT MUCH CASE LAW
  – STATE FILINGS REQUIREMENTS
WHICH TO CHOOSE?

- SOLE PROPRIETORSHIP OR GENERAL PARTNERSHIP
  1. LITTLE CAPITAL REQUIRED
  2. NO LIABILITY PROTECTION REQUIRED
  3. LIMITED ASSETS AT RISK
  4. NO SALE OF BUSINESS ANTICIPATED
WHICH TO CHOOSE?

• “C” CORPORATION
  1. LIMITED LIABILITY DESIRABLE
  2. PASS THROUGH INCOME IS NOT DESIRED
  3. LARGE GROWTH ANTICIPATED
  4. BROAD OWNERSHIP DESIRED
  5. BROAD ACCES TO CAPITAL DESIRED
  6. FUTURE SALE OF BUSINESS POSSIBLE
WHICH TO CHOOSE?

“S” CORPORATION WHERE:

1. BUSINESS WILL REMAIN RELATIVELY SMALL
2. CAPITAL IS RETAINED FOR GROWTH
3. NO SIGNIFICANT INVESTMENT IN APPRECIABLE ASSETS
4. LIMITED LIABILITY DESIRABLE
5. NO SPECIAL OWNERSHIP REQUIRED
6. SINGLE LEVEL OF TAXATION
WHICH TO CHOOSE?

- LIMITED LIABILITY COMPANY
  1. LIMITED LIABILITY IS DESIRABLE
  2. HOLDS APPRECIABLE ASSETS
  3. SPECIAL OWNERSHIP REQUIREMENTS
  4. PASSIVE ACTIVITY
  5. DISPROPORTIONATE DISTRIBUTION