Limited Liability Company (LLC)

- The LLC combines most of the favorable aspects of the partnership and corporation.
- An LLC is a business entity, separate from its owners, that provides the LLC member with a limited amount of liability, which is usually only common to corporations.
- In most cases, an LLC with two or more members is taxed as a partnership, passing its income and losses through to its members, avoiding the double taxation that is applicable to corporations.
- Single member LLCs that do not elect to be taxed as a corporation will report the income from the activity on Schedule C, Schedule F, or Schedule E as appropriate.
- The LLC can alternatively elect to be taxed as a corporation. Other attributes of the LLC will be determined by how the LLC is taxed. An LLC taxed as a corporation follows the corporation provisions and an LLC taxed as a partnership follows the partnership provisions.
- The LLC is formed under state law by filing Articles of Organization with the state.
- An LLC's Articles of Organization usually define who will be responsible for managing the LLC.
- Liquidation of a multi-member LLC will depend on whether the organization is taxed as a partnership or corporation.
- There is one major disadvantage of the LLC – they are a relatively new form of organization, which means there are still unresolved issues regarding their operation.

Limited Partnership

- This entity follows most of the partnership rules, but the limited partner is not (and cannot be) active in the business.
- The limited partner is an "investor" who shares in the profits and losses of the business based on his or her ownership percentage.

S Corporation

- This entity follows most of the rules of a corporation, but income and losses are passed through to the shareholder, thus avoiding double taxation.
- There are very specific rules that S corporations must follow regarding who can be an S corporation, how many shareholders are allowed, and what type of stock can be issued.

Summary

Understanding both the tax consequences and the operating procedures under each form of organization is vital to your success as a business owner. Your tax advisor can be an excellent source of information regarding entity considerations for your specific situation.

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This brochure contains general tax information for taxpayers. As each tax situation may be different, do not rely upon this information as your sole source of authority. Please seek professional advice for all tax situations.

NATP

Choosing Your Business Entity

Starting a business? One of the most important decisions you'll make is choosing what type of entity to operate as. A business can operate under five different forms (or entities). Your decision affects how you will be taxed and also plays a role in management, owner liability, ability to raise capital, and the liquidation process. As your business changes, it is possible to change your form of entity. This could be quite simple, or could turn out to be a very complex procedure. By making an informed decision initially, you can save a great deal of time and expense later.

Sole Proprietor

- The sole proprietor and the sole proprietorship are one and the same taxpayer; there is no separate legal entity.
- The sole proprietor is the owner of all the business assets and is liable for all business debts.
- Personal assets are subject to seizure by business creditors (to the extent available under state law).
- The sole proprietor is usually the manager of the business. His ability to raise capital is often limited to his own investments and the amount he is able to borrow, based on his personal credit.
- A sole proprietorship is the easiest type of business to form and to terminate.
- Quitting business can be as easy as saying, "I'm no longer in business."
- Unless assets are sold, there are seldom tax consequences upon liquidation.

Partnership

- Two or more individuals who make a voluntary contract to carry on a trade or business own a partnership. A partnership is a separate legal entity from its owners.
- The partnership is not a taxable entity. Instead, the income and expenses of the partnership are passed through to the partners and taxed on their individual income tax returns.
- Together, the partners are liable for the debts of the business, and personal assets may be subject to seizure by business creditors (to the extent available under state law).
- The partners usually share responsibility for the management of the business, but not necessarily on an equal basis.
- Partnerships can raise capital more easily than sole proprietors because the investment and liability is spread between more individuals.
- A partnership may also sell interests in the partnership to outside investors.
- A partnership is formed by a written or oral partnership agreement and terminated by death, withdrawal of a partner, or transfer of ownership interest.
- Liquidation is tax-free at the partnership level and allocated to each partner according to basis on the individual level.

Corporations

- A corporation is a separate legal entity apart from its owner. The corporation is responsible for all of its own transactions and can be sued separately from its shareholders.
- Shareholders have "limited liability" in corporate affairs.
- Personal assets of shareholders are seldom subject to seizure by corporate creditors, unless the shareholders have agreed to guarantee loans. This is one of the advantages of the corporate form of organization.
- Management is the responsibility of a board of directors, the shareholders themselves, or hired managers.
- The ability to raise capital is easier for a corporation than for any other form of organization. This is because the corporation issues stock and can sell additional stock if it needs to raise capital.
- The formation and liquidation of a corporation is more complex than any other type of entity.
- A corporation must be incorporated under state law and Articles of Incorporation need to be filed with the state.
- The board of directors generally must approve liquidation.
- At the entity level, assets are treated as sold for fair market value with the corporation recognizing the gain or loss on the corporate tax return.
- At the individual level, the shareholders recognize gain or loss based on the basis of their stock in the corporation versus the fair market value of assets received from the corporation.

Associations

- An association is an unincorporated business that is taxed as a corporation for federal tax purposes, even though it may not qualify as a corporation under state law.
- After January 1, 1997, an association is treated as a partnership unless it elects to be taxed as a corporation.