

To Be (an Entity) or Not to Be

Selma Goldstein, EA

Outline

- Background
- What is a business entity?
- Why does form matter?
- Major features of each entity
- Pros and cons
- Rule-of-thumb guidelines to choosing an entity

What is an Enrolled Agent?

Enrolled agents are tax professionals who are licensed by the US Treasury Department to represent taxpayers before all administrative levels of the Internal Revenue Service. This includes audit and collection negotiations in addition to preparing all manner of tax returns. Unlike most income tax return preparers, only enrolled agents, CPAs and attorneys may legally represent taxpayers in negotiations with the IRS.

The taxpayer representative emerged during the Civil War, when individuals needed intercession with the federal government to obtain refunds of the newly enacted income tax. The Enrolled Agent profession dates back to 1884 when, after questionable claims had been presented for Civil War losses, Congress acted to regulate persons who represented citizens in their dealings with the Treasury Department.

What is an Entity?

- A business entity is a legal structure that a business operates under.
 - The entity is separate from its owner(s).
- The form of the entity affects all aspects of business operations.
- Choices available
 - Partnership
 - Limited Liability Partnership
 - Certain professions or in foreign states
 - Limited Liability Company
 - Subchapter S corporation
 - Subchapter C corporation
 - Professional Services Corporation

Sole Proprietorship

- Definition
 - One individual operating an unincorporated business
 - Not defined as a business "entity"
 - Not legally distinguishable from owner
 - Fictitious Business Name Statement (Doing Business As)

Sole Proprietorship

- Advantages
 - Easy to form
 - Simple to run
 - Easy to dissolve
 - Income and losses pass through to owner
 - Lack of double taxation
 - Family employees w/o payroll taxes
- Disadvantages
 - Unlimited liability
 - Limited access to capital
 - Lack of continuity
 - Fiscal year accounting not allowed
 - SE tax on profits

Factors to Consider

- Business type
- Business location(s)
- Business maturity
- Number/types of owners
- Administrative costs
- Administrative complexity
- Exposure to liability
- Availability of fringe benefits
- Taxation of income/losses
- Taxation of distributions
- Access to capital

The Imponderables

- “Facts and circumstances”
- “Intent”

How you define your business and how the government – primarily taxing agencies – views your business may differ from each other

Partnership, Limited Partnership

- Definition

- Two or more individuals or entities operating a business
- Cannot be classified as another type of entity
- Each partner contributes property or services in exchange for an interest
- Profits/losses shared IAW ownership interest or partnership agreement
- Must have at least one general partner

Partnership, Limited Partnership

- Advantages
 - Easy to form
 - Easy to dissolve
 - Cash method of accounting allowed
 - No "double taxation"
 - Fringe benefits to spousal employees
 - Limited liability of limited partners
 - Income/losses pass through to partners
- Disadvantages
 - Unlimited liability of general partner(s)
 - SE tax on profits for general partners
 - Passive losses for limited partners
 - Partnership interest is a capital asset

Limited Liability Company/Partnership

- Definition
 - Entity formed of one or more managers
 - Restricted to certain businesses
 - LLP in CA available only for accountancy, law, architecture

Limited Liability Company/Partnership

- Advantages
 - Limited liability of managers
 - May elect partnership or corporate tax treatment
 - Taxation similar to S corporation
 - May be alternative to PSC
- Disadvantages
 - Professional LLCs restricted in CA
 - Legislated insurance requirements for LLP
 - Minimum tax on LLC same as franchise fee for C or S corporation

C/S/Professional Services Corporation

- Definition
 - Legally created “person” existing separately from owners
 - Activities subject to state and federal regulation
 - “S” is for “small”
 - Professional/personal services corporation not eligible for certain tax advantages

C/S/Professional Services Corporation

- **Advantages**
 - Limited liability of shareholders (restricted for PSC)
 - Continuity of existence
 - Availability of fringe benefits
 - Availability of fiscal year accounting (not for S)
 - Availability of capital
 - Unlimited number of shareholders for C
 - Income/losses pass through to shareholders for S
- **Disadvantages**
 - Costly to form
 - Costly to dissolve
 - Corporate "veil" may be pierced, exposing management to personal liability (also PSC)
 - Income taxed to entity and shareholders for C
 - Lowest rates not available to PSC
 - Shareholders limited to 75 for S

The Short Answer

- If you need:
 - Liability protection
 - Minimal FICA
 - Fringe benefits
 - Reduced income tax
 - Loss/credit passthrough
 - Simplicity
 - Continuity
 - Access to capital
- Then consider:
 - C-corp, S-corp, LLP, or LLC
 - S-corp
 - C-corp, LLC, or LLP
 - C-corp or partnership
 - non-C-corp
 - proprietorship or LLC
 - C- or S-corp
 - C- or S-corp