The Pros and Cons of Popular Business Entities: Sole Proprietorship, LLC, S Corp and C Corp

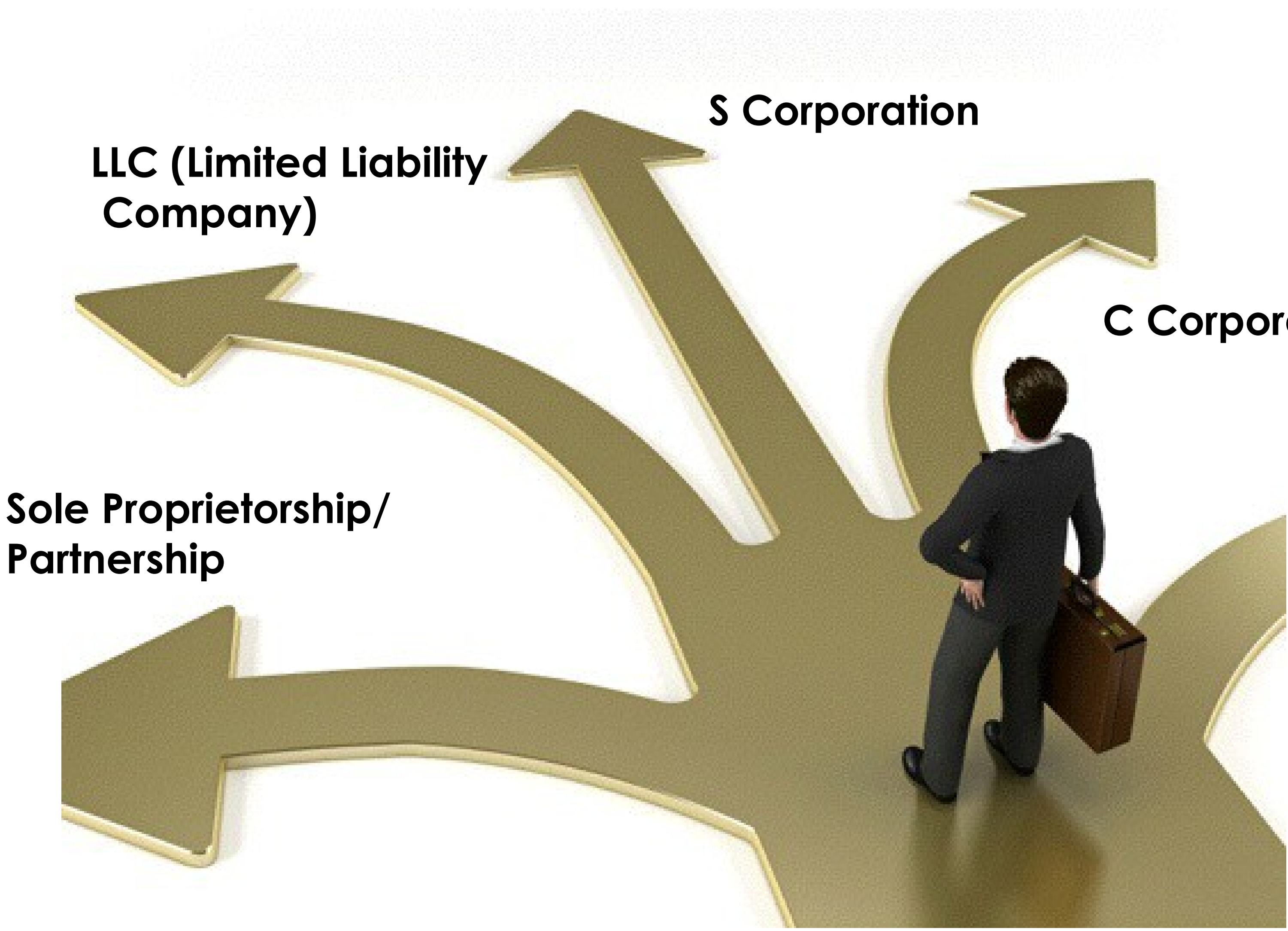

Choosing the
Right Legal Entity

Considerations When Selecting the Right Entity

- Separation of personal assets from business
- Tax implications
- Complexity vs Liability Protection
- Profit distribution and loss

Pros and Cons of Popular Legal Business Entities

Popular Entity Choices



Sole Proprietorship/Partnership

Pros

Advantages of operating a business as a Sole Proprietorship

- Simple to Form
    - Register the business name via a DBA if using a name different than your own.
    - If business name is your own name, you don’t need a DBA.
- Simple to Maintain
    - No financial statements or lengthy paperwork to stay compliant.
- Simple to Tax
    - Income earned by the business is considered income earned by owner.
    - Track income and expenses and report on Schedule C with personal tax return.

Cons

Disadvantages of operating a business as a Sole Proprietorship

- No Separation of Personal and Business Assets
  - Sole Proprietorship owners are personally liable for any debts of the business.
  - High risk of personal assets in the case of a lawsuit.
- Use of Personal Information
  - Sole Proprietorship owners generally have to sign contracts and paperwork in their own name because the business does not have a separate identity under the law.
- No Business Credit
  - Sole Proprietorships cannot gain business credit, take out business loans, or raise capital in other ways.

Pros

Advantages of operating a business as a Limited Liability Company

- Easy to Form and Manage
  - Less formation paperwork and ongoing compliance requirements. No need to create a board of directors, create annual reports or hold annual shareholders meetings.
- Asset Protection
  - When you form an LLC, you legally separate your personal self from your business creating a level of protection for personal assets.
- Tax Flexibility
  - LLC's can opt to have taxes treated as an S-Corporation or have business profits pass through to personal federal income tax return which can lower your personal income tax obligation.
- Professional Credibility
  - Forming an LLC can help instill confidence and trust in the eyes of customers, prospects, vendors and the business community when they see the "LLC" following your company name.

Cons

Disadvantages of operating a business as a Limited Liability Company

- Possible Confusion over Roles
  - If your LLC has multiple members, you may clash over who should be doing what and who is authorized to make certain decisions.
- Self-employment Tax
  - If you don't select S-Corporation tax treatment, all LLC profits will flow to your personal income tax return and get hit with the social security and Medicare taxes. Depending on your situation, that could result in more tax than if you'd be taxed as a corporation.
- Challenge to Grow
  - LLCs don't sell stock. With no shareholders as a source for generating funds, you may find it challenging to grow your business as quickly or to the degree you'd like.

Pros

Advantages of operating a business as a S Corporation

- Tax Savings
  - An LLC or a Corporation that chooses S Corp election will have its profits and losses flow through to its shareholders (owners), who then report them on their personal income tax returns. Not all income is subject to self-employment taxes—only owners' salaries are.
- Asset Protection
  - Because the S Corporation is an election of an LLC or C Corporation, it is considered a legal entity separate from its owners creating protection for personal assets.

Cons

Disadvantages of operating a business as a S Corporation

- **Limitations**
  - If your business is a C Corporation choosing to be treated as an S Corp, you may only have up to 100 shareholders, and you can issue just one class of stock.
- **Cost and Complexity**
  - If your business is an LLC choosing to be treated as an S Corp, you may experience higher formation costs and more compliance complexity.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Pros

Advantages of operating a business as a C Corporation

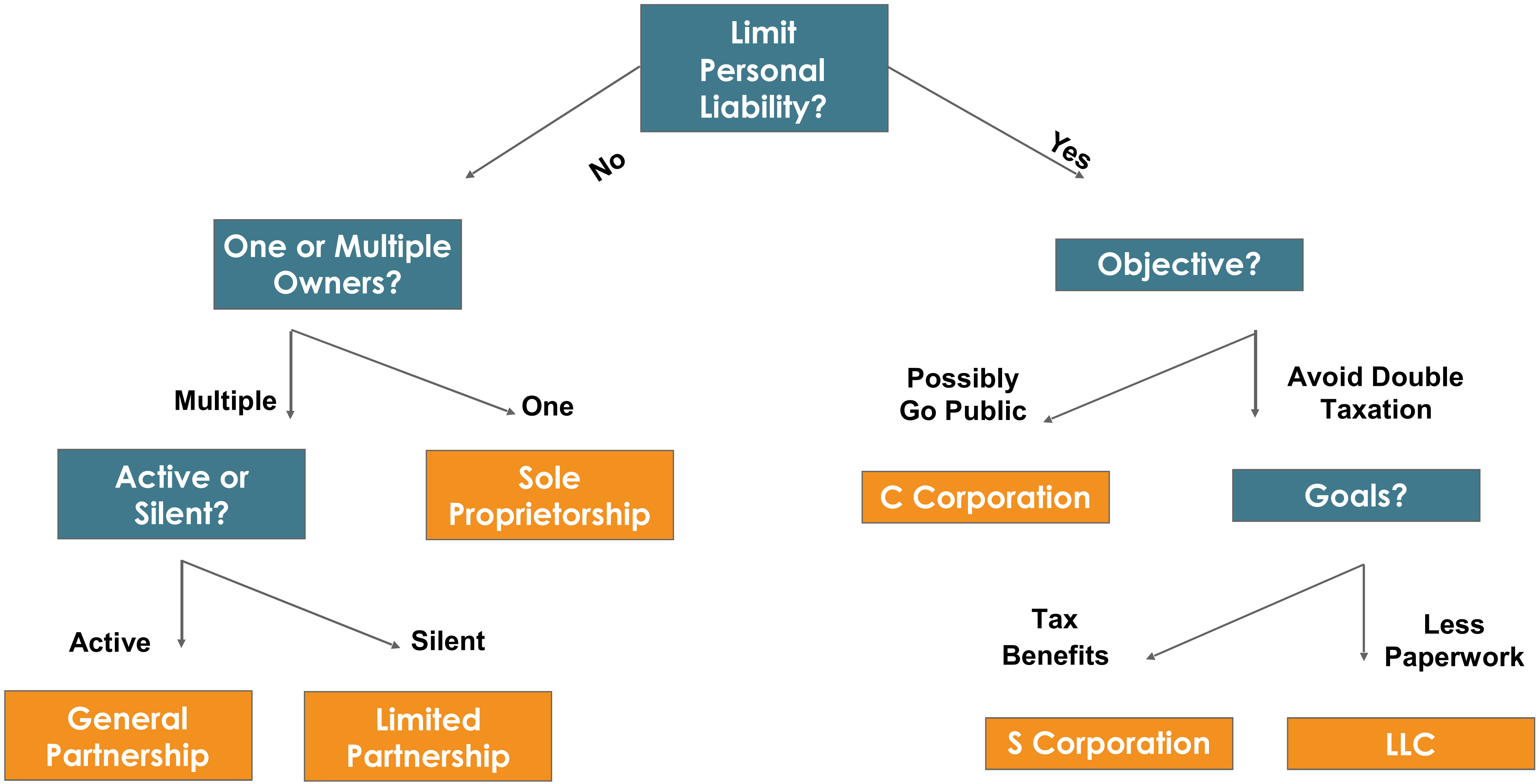
- Asset Protection
  - A C Corporation provides the most personal liability protection for shareholders in a company.
- Growth Potential
  - A C Corporation has more potential to raise capital and grow. It can issue multiple classes of stock, and it may have an unlimited number of shareholders.
- Longevity
  - Unlike with a sole proprietorship (and in the case of some LLCs), a C Corporation will survive beyond its owners’ life spans.

Cons

Disadvantages of operating a business as a C Corporation

- Cost and Complexity
  - A C Corporation has more compliance requirements and costs more to register than other business entity types.
- Double Taxation
  - Generally, C Corporations are subject to double taxation - when profits distributed to shareholders as dividends are taxed again at the individual tax rate on shareholders' tax returns.


Recap
Choosing a Structure for Your Business


Limit Personal Liability?
No
Yes
One or Multiple Owners?
Objective?
Multiple
One
Possibly Go Public
Avoid Double Taxation
Active or Silent?
Sole Proprietorship
C Corporation
Goals?
Active
Silent
Tax Benefits
Less Paperwork
General Partnership
Limited Partnership
S Corporation
LLC

	Sole Proprietorship/ Partnership	LLC	S Corp	C Corp
Formation	***None***	State Filing Required	State Filing Required	***State Filing Required***
Limited Personal Liability	***No***	***Yes***	***Yes***	***Yes***
Transferability of Interest	***No***	***Yes: Often Limited***	***Generally Limited***	***Yes***
Duration	***Until Withdrawal or Owner Death***	Unlimited	Unlimited	Unlimited
Pass-through Taxation	***Yes***	***Yes: Upon Election***	***Yes***	***No***
Ability to Raise Capital	***Not as Separate Entity***	***Yes***	***Yes: Shareholder Limits Exist***	***Yes***
Limitations on Number of Owners	***Yes***	***No***	***Yes***	***No***

	Initial Filing Requirements	Annual Compliance Requirements	Registered Agent Required
Sole Proprietorship/ Partnership	*None*	*None*	*No*
Limited Partnership	*Initial Filing* *(Some States)*	*Annual Reports* *(Some States)*	*Yes* *(Some States)*
C Corporation	*Initial Filing* *Initial Report* *Publication Fees*	*Annual Reports* *Annual Meetings* *Meeting Minutes*	*Yes*
S Corporation	*Initial Filing* *Initial Report* *Publication Fees*	*Annual Reports* *Annual Meetings* *Meeting Minutes*	*Yes*
Limited Liability Company	*Initial Filing*	*Annual Reports*	*Yes*


TAX REFORM
TAX RATE
TAX+
TAX-
SET
%
C1
C2

Tax Reform & S Corporations

- 20% tax reduction for pass through tax entities
- For taxable years beginning after December 31, 2017 and before January 1, 2026, individuals can generally deduct 20% of their qualified business income (QBI) from a pass- through entity (like an S Corp, partnership, sole prop
- S Corporations are still advantageous in many situations, though are increasingly risky in others – particularly in passive income situations (i.e. rental real estate income)

Tax Reform & C Corporations

- In 2017 individual tax rates ranged from 10% to 39.6%, and corporate rates ranged from 15% to 39%.
- Under the new tax law C Corps will be taxed at a flat rate of 21%—good news for most C Corps.
- To avoid the complexity of the new rules about pass-through taxation, many business owners might be swayed to reorganize and change to C Corp status so they can take advantage of the flat 21% corporate tax rate.

The Bottom Line

- S Corps are still advantageous in many situations, though are increasingly risky in others – particularly in passive income situations (i.e. rental real estate income).
- C Corps shouldn't necessarily look to elect S Corp status just because of this tax bill, especially if the corporation isn't contemplating a sale or closure in the foreseeable future.

While the corporate tax rate is "permanent," the deduction based on QBI is set to expire at the end of 2025 (it could also be eliminated by Congress after 2020 too).

The Bottom Line

- Business owners should continue to think about their business structure in terms of their specific business needs and practices, as opposed to focusing solely on the changes from the Tax Cuts and Jobs Act. It’s also smart to wait for the IRS to release additional guidance on abusive situations.
- And lastly, one of the key advantages in forming a corporation remains the ability to minimize the personal liability of the business owners. This advantage is unaltered by the new tax bill.