

2008 Tax Comparison of C Corporation, S Corporation & Limited Liability Company

By: Monica Bailey, CPA

| | <u>C Corporation</u> | <u>S Corporation</u> | <u>LLC (Limited Liability Company)</u> | |
|--|--|--|--|----------|
| Company taxed for federal tax purposes | Yes | No | No | |
| Federal Income Tax Rates on taxable income | 15% of first \$0 - \$50K 25% of next \$25K 34% of next \$25K 39% of next \$235K 34% of next \$8.665M 35% of next \$5M 38% of next \$3.33M 35% of excess of 18.33M | None | None | |
| California Income Tax Rates on taxable income | 8.84% with an \$800 minimum per year | 1.5% with an \$800 minimum per year | None | |
| California Total Annual Income Fee (gross receipts) | None | None | \$0 - 249,999 | \$0 |
| | | | \$250K - \$499,999 | \$900 |
| | | | \$500K - \$999,999 | \$2,500 |
| | | | \$1M - \$4,999,999 | \$6,000 |
| | | | \$5M and over | \$11,790 |
| How is the entity's income treated for tax purposes? | As C Corporation income | As S Corporation income | <i>Single member LLC</i> - as a sole-proprietorship <i>Multi-member LLC</i> - generally as a Partnership (Still must pay LLC fees) | |
| Are any of the members subject to self-employment tax on their distributive share of income? | N/A | Shareholders of an S Corporation can reduce or eliminate their self-employment tax on their distributive share of income | The managers of an LLC are subject to self-employment tax on their distributive share of income | |
| Taxable income passed-through to shareholders / members for inclusion in their taxable income | None | 100% | 100% | |

2008 Tax Comparison of C Corporation, S Corporation & Limited Liability Company

By: Monica Bailey, CPA

| | <u>C Corporation</u> | <u>S Corporation</u> | <u>LLC (Limited Liability Company)</u> |
|---|---|--|--|
| Portion of dividends and distributions tax deductible by company | None | None | None |
| Portion of dividends and distributions taxable to shareholders/members | 100% | Generally none | Generally none |
| Maximum number of shareholders/members | No limitation | 100 (Generally shareholder & spouse are considered as 1 shareholder rather than 2 shareholders) | No limitation |
| Types of entities able to be shareholder/member | All entity types | Generally only individuals | All entity types |
| Can there be different classes of ownership interest? | C Corporations may issue different classes of stock | S Corporations may issue only one class of stock | LLCs may issue different classes of ownership interest |
| Shareholder/Member residency limitations | No limitation | All must be United States residents | California nonresident members must sign a consent to be taxed by California on their distributive share of income |
| Fiscal year-end allowed | Any month | December 31 | December 31 |
| How does a C Corporation convert either to an S Corporation or an LLC? | N/A | File Form 2553 with the IRS no later than 2½ months after Incorporation or the C Corporation's fiscal year-end | Reorganize with the California Secretary of State as an LLC |
| Who must sign the election forms? | N/A | All shareholders and their spouses (whether or not the spouses are shareholders) | Officers of the Company, especially the member designated as the tax matters member |

2008 Tax Comparison of C Corporation, S Corporation & Limited Liability Company

By: Monica Bailey, CPA

| | <u>C Corporation</u> | <u>S Corporation</u> | <u>LLC (Limited Liability Company)</u> |
|--|--|---|--|
| How and when are the shareholders/members notified of their portion of taxable income? | N/A | Schedules K-1 of the corporate tax return are prepared for each shareholder and distributed by March 15 of each year for the previous year, unless the Corporation files for an extension to file, at which point the deadline is extended until September 15 | Schedules K-1 of the company tax return are prepared for each shareholder and distributed by March 15 (if corporation election was made) or April 15 (if partnership or single-owner/sole-proprietor election was made) of each year for the previous year, unless the entity files for an extension to file, at which point the deadline is extended until September 15 (if corporation election was made) or October 15 (if partnership or single-owner/sole-proprietor election was made) |
| What happens if all of the profits aren't distributed at the end of the year? | They are taxed and added to the retained earnings of the corporation | They are added to the cost basis of each of the shareholders | They are added to the cost basis of each of the members |
| What happens if the company distributes more than the current year profits? | Taxed to shareholder as dividends or treated as a return of investment if there are no retained earnings | Treated as a return of basis unless prior to the S-election the corporation had C Corporation profits; C-Corporation profits will be treated as taxable dividends to the extent of retained earnings | Treated as a return of basis unless prior to the LLC conversion, the company had C Corporation profits; C Corporation profits will be treated as taxable dividends to the extent of retained earnings |
| What expenses are not allowed deductions for the flow-through entities that may be allowed for a C Corporation? | N/A | Shareholder's health premiums by 2% or greater shareholders - the amounts are deductible as self-employed health insurance premiums on the individual's personal income tax returns | Shareholder's health premiums by 2% or greater shareholders - the amounts are deductible as self-employed health insurance premiums on the individual's personal income tax returns |

2008 Tax Comparison of C Corporation, S Corporation & Limited Liability Company

By: Monica Bailey, CPA

| | <u>C Corporation</u> | <u>S Corporation</u> | <u>LLC (Limited Liability Company)</u> |
|--|--|---|--|
| Is there flexibility in special tax allocations? | Dividends must be allocated in accordance with stock ownership | Income, gain, loss, deductions, or credits must be allocated in accordance with stock ownership | Special tax allocations of income, gain, loss, deductions, or credits may be made among the LLC members (pursuant to IRC Section 704) |
| Can change in ownership cause termination? | No | No | <i>For tax purposes</i> - whenever 50% or more of the interest in capital and profits are sold within a 12 month period <i>For registration purposes</i> - No |
| What happens if the entity terminates due to change of ownership? | N/A | N/A | It has the same effect as establishing a new entity for accounting purposes, and brings the current LLC tax year to a close |

NOTE: It is necessary to consult with an attorney to understand the legal differences between entity types. Additionally, it may be necessary to do business under a specific structure for many reasons that should be discussed both with a CPA and an attorney working together to protect the interests of the client.

NOTE: This newsletter represents a general overview of tax developments and should not be relied upon without an independent, professional analysis of how any of these provisions may apply to a specific situation. This information is not a substitute for a personal consultation with a CPA.

DISCLAIMER: This advice is not intended or written to be used, and cannot be used by recipient, for the purpose of (i) avoiding penalties that may be imposed under the Internal Revenue Code or applicable state or local tax law provisions or (ii) promoting, marketing, or recommending to another party any transaction or matter addressed herein.