

Corporation vs. Limited Liability Company

The following is a brief outline of the reasons to choose one form of business over another. It is not meant to be all inclusive and if you have any questions you should consult an attorney or accountant before making your final decision.

All of these entities offer limited liability protection. The differences are in the tax treatment.

Regular Corporation

A standard corporation files its own income tax return (Form 1120) and pays its own taxes. Not very common for small businesses.

Subchapter S Corporation

A Sub S corporation files its own income tax return (Form 1120S) but the income or loss is reported on the shareholder's individual tax returns and the shareholders pay the tax on their share of the taxable income or take the benefit of their share of any losses.

Limited Liability Company with multiple owners

A Limited Liability Company with more than one owner files its own tax return (Form 1065) but the income or loss is reported on the partner's individual tax returns and they pay the tax on their share of the taxable income or take the benefit of their share of any losses.

Limited Liability Company with one owner

A Limited Liability Company with one owner (husband/wife can be treated as one owner) does not need to file its own tax return. Rather, the income is reported on the owner's personal income tax return (Form 1040 Schedule C or Schedule E) and they pay the tax on the taxable income of the business or take the benefit of any losses.

The major difference between a Sub S corporation and a Limited Liability Company is in the area of payroll taxes. Owners of Sub S corporations are treated as employees and owners of LLCs are treated as partners or proprietors. There can be significant payroll tax savings with a Sub S corporation if the company's profits start to get larger. *These savings do not apply if the LLC's income is from rental real estate. See the attached analysis.*

Recommendations

Regular Corporation: Consider using a regular corporation only for businesses that will require you to retain most of the profit in the corporation to purchase inventory or machinery, such as large wholesalers, retailers of manufacturers. Very few small businesses use this status.

Limited Liability Company: Use an LLC in the following situations (1) Rental real estate, or (2) One owner business that will not have employees and will not have net income in excess of approximately \$20,000.

Subchapter S Corporations: Consider using a Sub S corporation for a multiple owner business or a one owner business that will have employees or a significant net income. See the attached analysis.

One final note. It is very easy to convert an LLC into a corporation. It is much more difficult to convert a corporation into an LLC.

