

# **Another Look at Limited Liability Companies in Light of the TCJA**

**Presented by:**

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# Learning Objectives

At the end of this course, you will be able to:

- Define a Limited Liability Company (LLC)
- Differentiate between single member and multi-member LLC taxation options
- Determine which taxing entity may be best for the LLC including consideration of the Tax Cuts and Jobs Act (TCJA)



# What is an LLC?

- A Limited Liability Company
- A legal entity “organized” under state law
- It provides liability protection to its owners with pass through taxation
- It is not recognized for federal tax purposes
- Popularity has surged over the last 10 years!
- IRS Pub 3402 – Tax Issues for Limited Liability Companies (2016)

# How is an LLC Organized?

- Register with Secretary of State
- Articles of Organization
- Operating Agreement
- Member / Member Manager
- Member Units
- Do you need an EIN?



# An LLC & Federal Income Tax

- By default, it is a pass-through entity
- Single member (one member) default status is a “disregarded entity”, Schedule C, Sole Proprietor
- Multi member (two or more members) default status is Form 1065, Partnership
- May elect to be taxed as a Corporation by Form 8832
- May make the S-election by filing Form 2553

# Advantages of an LLC

- Choice for taxation
- Liability protection for members
- Flexibility in ownership
- Administrative requirements less than a corporation
- Allocation of income, gain, loss, etc. provides flexibility



# Disadvantages of an LLC

- State regulation laws vary widely
- Administrative requirements less than a corporation
- Potential franchise fees



# Other LLC Variations

- PLLC = Professional Limited Liability Company
  - Organized to provide professional services
  - Varies from state to state
- Series LLC
  - Single LLC that allows the segregations of assets into separate series
  - Each series is treated separately
  - Only allowed in some states

# Single Member LLC Default

- “Disregarded Entity” – not separate from its owner for tax purposes
- Schedule C, C-EZ, E or F
- Simple and low-cost
- No payroll for owner member; minor child wages



# Single Member LLC Default

- Net profit subject to self employment tax (SE)
- Net profit may qualify for the 20% qualified business income (QBI) deduction
- Net losses can and be deductible up to at-risk limits and offset other income
- Administrative ease – dissolution

# Multi Member LLC Default

- Taxed as a Partnership, Form 1065
- Tax free formation and dissolution – usually!
- No payroll for owner member, no W-2
- Guaranteed payments
  - Subject to SE
  - Reduces QBI



# Multi Member LLC Default

- Pass through taxation of profits to members
  - Active trade or business, SE
  - Passive Activity, no SE.... Maybe!
  - May qualify for the QBI deduction
- Disproportionate allocations
- Loss limitations – Debt basis, At-Risk
- Unreimbursed partner expenses (UPE) may be deductible – bigger issue with TCJA

# LLCs Taxed as a C Corporation

- Corporation Election, Form 8832
- Administrative costs
- Payroll for owner member
- Fringe benefits – bigger issue with TCJA
- Double taxation issues, no pass through taxation

# LLCs Taxed as a C Corporation

- TCJA 21% tax rate including PSCs
- Corporate liquidation
- Lower audit risk



# LLCs Taxed as an S-Corporation

- S-election, Form 2553
- Administrative costs
- Payroll for owner member
- Ownership limitations
- 2% shareholder rules



# LLCs Taxed as an S-Corporation

- Pass through taxation on net profit / loss, no SE
- Loss limitations; Basis and At-risk
- Net profit may qualify for the QBI deduction
  - No employee business expense deduction

# Form 8832

- An eligible entity elects how it will be classified for federal tax purposes
- Default rule
- File this form in these situations
  - A domestic entity electing to be classified as a C Corporation
  - A domestic entity electing to change its current classification

# Form 8832

- Each owner member must sign
- Electing S status with form 2553, you do not need to file form 8832
- Acceptance or nonacceptance letter
- Not always required in the first year of LLC
- Late Entity Election, Rev Proc 2009-41
- 60 month limitation rule

# Form 2553

- Election to be treated as an S-Corporation
- Eligibility... LLC Beware!
  - Owner limitations
  - Tax year
- Each owner member must sign, including spouses
- Acceptance or nonacceptance letter
- Late election (Rev Proc 2013-30)

The image shows two IRS forms. The primary form in the foreground is Form 2553, titled "Election by a Small Business Corporation (Under section 1362 of the Internal Revenue Code)". It includes a "Note" stating that the election to be an S corporation can be accepted only if all the tests are met and that shareholders must sign a consent statement. Below the note is "Part I Election Information", which includes fields for "Name (See instructions)", "Type or Print", and "Number, street, and room or suite no. (if a P.O. box)". The form is dated "Rev. December 2013". In the background, the top portion of Form 1040, "U.S. Individual Income Tax Return", is visible, showing the title and various boxes for tax information.

# Which LLC Taxation Entity is Right for Your Client?

- Tax factors
  - Federal Consequences
  - Tax rates, QBID
  - What type of business? SSTB?
- Non tax factors
  - Owner's needs and desires
  - Characteristics & needs of the business
    - Formality of existence
    - Ability to raise capital
    - Participation in management

# Which Entity? Be Sure and Review...

- Number of members
- Capitalization
- Administrative discipline
  - Payroll
  - Filing requirements
- Debt structure
- Basis



# Changing Tax Elections

- 5-year rule – need to think ahead!
- Sole Proprietorship to S-Corporation
  - May decrease QBID
  - Save on SE tax
  - No new EIN required
  - May lose deductions without an accountable plan in place

# Changing Tax Elections

- Sole Proprietorship to C Corporation
  - Forgo QBID
  - 21% tax rate
  - Save on SE tax
  - No new EIN required
  - Double Taxation
  - Deductible fringe benefits



# Changing Tax Elections

- S-Corporation to Sole Proprietorship
  - Taxable as corporate liquidation
  - May increase QBID
  - All income subject to SE tax
  - Possibly form new LLC and let corporation dissolve

# Changing LLC Tax Elections

- S-Corporation to Partnership
  - Taxable as corporate liquidation
  - May increase QBID
  - No payroll for members



# Changing Tax Elections

- Partnership to Corporation
  - Contribute assets and liabilities of the partnership for stock
  - May decrease QBID
  - May decrease deductions – no UPE
  - Payroll for members

# What We've Done the Last Hour...

- Defined a Limited Liability Company (LLC)
- Differentiated between single member and multi-member LLC taxation options
- Determined which taxing entity may be best for the LLC including consideration of the Tax Cuts and Jobs Act (TCJA)

# **For More Information**

## **National Society of Accountants**

More information is available at:

NSA Booth in the Vendor Hall

Or at the NSA table in the lobby

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