LLCs In The Real World

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What is a LLC?

- Legal entity
- LLC is a term of state law, not of federal law
- Combine Individual, Partnership and Corporate rules
- Organized separate and apart from owners
What is a LLC, Cont.

- Offers limited liability similar to Corporate veil

- Not a tax entity
  - Options for tax treatment

- Flexible vehicle for business
  - Contractual
  - Statutory
  - Management style
Birth

- LLC
  - Articles of Organization
  - Operating Agreement
  - Other state-required forms
Birth, Cont.

- Not a Tax Entity

- Titling of Assets

- Operations
  - Separate entity
Entity Classification

- Sole Proprietor
  - Disregarded

- Partnership
  - Default

- S Corp
  - Form 2553

- C Corp
  - Form 8832
Partnership

- Assets transfer to partnership
- No recognition of gain
  - Unless liabilities > basis of property transferred

Corporations (S and C)

- No recognized gain or loss if stockholder has control upon transfer
  - Unless: liabilities > basis of assets transferred
- Only allowed to receive stock as consideration
Taxation

- Partnership, LLC
  - Allocate income/deductions by agreement
    - Substantial economic effect

- S Corp, LLC
  - No allocation of income/deductions allowed
  - Income/deductions prorate per share

- C Corp, LLC
  - Preferred stock for dividend preferences
  - Losses deductible at corporate level
Taxation, Cont.

- Basis Adjustments
- Loss Limitations
- Passive Investment Income
- Passive Activity
- Built-in Gains Tax
- At-Risk
Compensation and Payroll Tax

- **Partnership**
  - Guarantee payment - SE tax

- **S Corporation**
  - Reasonable compensation
  - Payroll taxes on salaries

- **C Corporation**
  - Reasonable compensation
  - Payroll taxes on salaries
Distribution - General Rule

- Partnership, LLC
  - Distribution not taxable
  - Basis in asset distribution equal to partnership basis

- S Corp, LLC
  - Distribution at FMV
    - Any gain at Corp level
    - Basis of distribution: FMV

- C Corp, LLC
  - Distribution = Dividend = Double taxation
  - Basis of distribution: FMV
Liquidation or Dissolution

- Partnership Dissolution
  - Choice of partners, or 50% or > change in owners in 12 months
  - Proportionately distributed assets = no tax to partners
  - Disproportionate distribution = deemed sale = recognized gain

- S Corporation
  - Single taxation
    - Built-in gain if dissolution within 10 years of S election

- C Corporation
  - Double taxation
Why Should I Be

- Sole Proprietor, LLC?
  - Easy start-up
  - Full control
  - Lower cost
  - Less required record keeping
Why Should I Be Partnership, LLC?

- Flexibility
- Distributions
- Pass through taxation
- Minimal formalities
- 754 Election
Why Should I Be

- S Corp, LLC?
  - Reasonable compensation
  - Gain treated as profit, not wages
  - No SE on profits
  - 2553 election
Why Should I Be

- C Corp, LLC?
  - No limit to number of owners
  - Premier entity for going public
  - Attractive for investors
  - Retention of profits
  - 8832 election
Entity Choice Consideration

- Who is your taxpayer?
- Future sale?
- Estate and gift planning?
- Asset protection?
Multiple LLCs in a Business

- Separate liability
- Deflects business operations
- Changes in future
  - Sale
  - Retirement
Partnership to Partnership, LLC
- No tax effect to transfer assets
  - Unless liabilities assumed are $>\text{basis of transferred assets}$

Partnership to S Corp, LLC
- No tax effect to transfer assets
  - Unless liabilities assumed are $>\text{basis of transferred assets}$

Partnership to C Corp, LLC
- No tax effect to transfer assets
  - Unless liabilities assumed are $>\text{basis of transferred assets}$
Changing to Another Type of Entity, Cont.

- S Corp to:
  - S Corp, LLC or C Corp, LLC election
    - No gain/loss recognized

- S Corp to:
  - Partnership, LLC or Sole Proprietor, LLC conversion
    - Gain or loss recognized
C Corp to:
- Partnership, LLC or Sole Proprietor, LLC
  - Gain/loss recognized

S Corp, LLC election
- No gain/loss recognized
  - Unless LIFO used
Summary