



National Association
of Tax Professionals

LLCs In The Real World

Larry L Gray, CPA

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

Forming Entity

- 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

Changing to Another Type of Entity

- Partnership to Partnership, LLC
 - No tax effect to transfer assets
 - Unless liabilities assumed are > basis of transferred assets

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

- Partnership to C Corp, LLC
 - No tax effect to transfer assets
 - Unless liabilities assumed are > 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

Changing to Another Type of Entity, Cont.

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

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

Summary