

LLC or S-Corporation?

One of the questions I get most is should a buyer form an LLC or an S-Corporation?

Most of the time people form an LLC without getting adequate legal and tax advice because someone told them “ that is the best way to do it. “

There is no standard answer to this question. Each individual situation should be analyzed for the best choice of entity. A buyer should always seek legal counsel regarding liability and business reasons for the choice of entity.

Here are a few of the main differences between the two in layman’s language.

- * S Corp earnings have to be allocated based on ownership percentages; LLC earnings can be allocated according to whatever formula the members agree to.
- * An LLC usually has a limited life and the interests are not freely transferable. The LLC usually terminates upon death or disability of one of the members. A corporation usually continues unless legally terminated and the interests in a corporation are usually freely transferable (seek legal counsel).
- * Distribution of appreciated property, such as real estate, is a taxable event at the entity level in an S Corporation and is not a taxable event at the entity level if distributed from an LLC. Simply put, you probably don’t want to own real estate or other appreciating property in an S Corporation.
- * An S Corporation is more formal regarding the keeping of corporate minutes and other corporate formalities; the LLC is less formal and less restrictive (seek legal counsel).
- * For tax purposes, with some exceptions such as an LLC for the rental of real estate, the net income of an LLC used for an active trade or business is treated as self-employment income of the members and is subject to 15.3% self-employment tax. The net income of an S Corporation is not subject to self-employment tax but the shareholders of an S Corporation are required to pay themselves a reasonable salary.

These are just a few examples and are certainly not all-inclusive. You should advise your clients to seek adequate legal and tax advice before forming a new entity so they can make an informed and educated decision. As you can see, forming an entity based on a friend’s or associate’s advice is not a valid reason for choice of entity.

Please contact one of your GABB attorneys or tax advisors for additional information regarding choice of entity.

Article courtesy of our Strategic Partner, --Greg DeFoor, CPA, Winslett & DeFoor CPAs PC

Please contact us for more information and a CPA or Attorney referral

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