Tax Savings Features of Corporations, S Corporations and LLCs
Nellie Akalp, CorpNet CEO:

Nellie Akalp is an entrepreneur, business expert, professional speaker, published author, and mother to four amazing kids. Nellie has dedicated her entrepreneurial career to helping other entrepreneurs and business professionals succeed at business ownership.

As CEO and Co-Founder of CorpNet.com, she has helped more than half a million small businesses and licensed professionals get their businesses and clients off the ground. She has developed a strong following within the small business community and has been honored as a Small Business Influencer Champion and was named women entrepreneur of the year by NAWBO.
Today’s Agenda

Goal: Understand the tax advantages and disadvantages of business entities

- Benefits of Business Incorporation
- Overview of the C Corporation, S Corporation and LLC
- Tax Advantages and Disadvantages
- Tax Cuts and Jobs Act
- Helping Clients Select An Entity
- Steps to Get Started
- Entity Conversions
- Helpful Resources
Benefits of Incorporating a Business
Many of your sole proprietor and general partnership clients may be wondering if it’s time to create a formal business structure. If your client is still on the fence, here are some major reasons a small business would choose to incorporate or form an LLC:

- Liability protection of personal assets
- Separate legal entity
- Added credibility
- Perpetual existence
- Tax flexibility
- Deductible expenses
Overview:
C Corporation, S Corporation and LLC
Understanding the Basics

- C Corporation
- S Corporation
- LLC (Limited Liability Company)
- Sole Proprietorship/Partnership
C Corporation

- Owned by shareholders and run by an elected board of directors
- Owners often shielded from personal liability
- Can be subject to “Double Taxation”
- Typically not ideal for small businesses unless they are going public or seeking VC funding
S Corporation

- S Corporation is a C Corporation that elected pass-through tax treatment with IRS
- Must meet strict requirements with the IRS to qualify for S Corporation status
- Owned by shareholders and run by board of directors
- Must hold annual shareholders’ meeting and directors’ meetings, document key shareholder decisions and file separate corporate income tax return
- Tax designation granted by the IRS that lets corporations pass their income through to their shareholders
Limited Liability Company

- LLC combines elements of a sole proprietorship, partnership and corporation
- Helps shield owners from personal liability
- Less complex to run and manage
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<th>Business Formation Overview</th>
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<td><strong>C Corporation</strong></td>
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Tax Advantages and Disadvantages
C Corporation - S Corporation - LLC
C Corporation and Taxes

- **Corporate Income Tax Rate May be Favorable:** A C Corp’s profits get taxed at the corporate income tax rate. In some circumstances, that might work in the business owners’ favor. Depending on the location and shareholders personal tax situation, they might find the corporate tax rate will cost them less than if they were set up as an LLC.

- **Possibly More Tax Deduction Opportunities:** As a C Corp, the business may be eligible for more tax deductions than if it were an LLC, partnership, or sole prop.

- **S Corporation Options for Qualifying C Corporations:** Eligible C Corps may be taxed as an S Corporation enabling them to avoid the sting of “double taxation.”
C Corporation and Taxes

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**Disadvantage**

**A Double Tax Hit**

A C Corporation’s profits are taxed when they are earned. Then, any of the profits paid as a dividend income to shareholders is taxed again on the shareholder’s individual tax returns.
S Corporation and Taxes

- **Lessens the Self-employment Tax Burden on LLC Members:** Only income paid to LLC members on the payroll are subject to self-employment taxes. Profits paid as distributions are not subject to Social Security and Medicare taxes so LLC members may find that the S Corporation election lowers personal tax burden.

- **Enables C Corporations to Avoid Double Taxation:** As an S Corporation, a corporation’s profits and losses flow through to shareholders’ personal tax returns and are taxes at the individual tax rates. The corporate entity does not pay income tax. Shareholders that are employees of the C Corporation only pay self-employment tax on the wages or salary that the Corporation pays them. Dividend income paid to shareholders is not subject to self-employment tax; those mone=ies are taxes as either ordinary income or qualified dividends.
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**Disadvantage**

May limit Growth Potential

S Corps may not have more than 100 shareholders, so growth potential may be limiting.

**Reasonable Compensation Key**

An LLC must pay its owners fair compensation for the work they perform to avoid red flags with the IRS.

S Corporations not treated equally at the state level
Limited Liability Company and Taxes

- **Single Member LLCs**: Taxed as sole proprietorship by default
- **Multi Member LLCs**: Taxed as partnership by default
- **S Corporation Election Option for Qualifying LLCs**: LLC members may elect to have their LLC treated as an S Corporation for tax purposes.
- **Owners Choose How to Distribute Profits**: LLC members may choose how their business will divide the company’s profits and losses among its owners allowing for members to consider not only money invested but time and work invested when distributing profits.
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**Disadvantage**

**Bigger Self-Employment Tax Burden**

All of an LLC’s business profits are subject to Social Security and Medicare taxes. This may create an unfavorable financial situation for LLC owners as they must pay self-employment taxes on their distributive share of the LLC’s profits, even if invested back into the business.

Members of an LLC cannot be employees of an LLC.
Tax Cuts and Jobs Act
Tax Cuts and Jobs Act made tax law changes that affected every business.

Corporations and pass-through business entities have the most tax savings potential under TCJA.
Changes for Corporations

Corporations feel the biggest impact from TCJA, primarily in a positive way

- C Corporations now taxed at a flat rate of 21% (including personal service companies)
- No longer required to calculate alternative minimum tax rates, however, they may be able to use AMT credit carryovers until 2021
- Still allowed to partially deduct dividends, but not as much as before TCJA
Changes for Pass-Through Businesses

Before TCJA, taxable income from sole proprietorships, partnerships, S corporations, and LLCs were simply passed through to owners and taxed at those individuals’ standard rates. Under TCJA, pass-through businesses will still be taxed at individual rates, minus deduction of 20%.

The deduction was created to lower the tax rate for these non-corporation businesses but there are stipulations:
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- Deduction must be equal to 20% of the QBI earned from the business
- Much of the business’s income is excluded from QBI giving a smaller deduction
- QBI does not include interest, dividends or capital gains from property sales
- Deduction restricted to the lesser of 20% QBI, or 50% of the total W-2 wages paid by the business
- 20% may not apply for businesses where “the principal asset is the reputation or skill of one or more of its employees or owners.” That includes services in the fields of health, law, accounting, actuarial science, performing arts, consulting, athletics, financial services, investing and investment management and trading.
Helping Clients Choose the Right Entity
Questions to Ask

As you’re looking at potential business structures for clients’ businesses, there are many factors to consider. Here are some:

○ Does your client have personal assets?
○ Is your client concerned about personal liability?
○ Does your client need to live off of the business’ profits each year?
○ Does your client want to keep paperwork and administration as simple as possible?
○ Does your client want to keep the business ‘forever’?
Self-Employed Clients

Currently, the SE tax rate is 15.3% which includes a 12.4% Social Security tax and a 2.9% Medicare tax (or higher if earnings reach certain thresholds).

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<th>How can an S Corp Help?</th>
<th>How can an LLC Help?</th>
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<td>Client could classify some earnings as salary and some as distribution</td>
<td>Advantage depends on number of members/owners of the LLC</td>
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<td>Employees liable for the 15.3% SE taxes on salary, but regular tax on distribution</td>
<td>If sole member, LLC does not pay taxes or file return - all profits claimed on client’s personal tax return</td>
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<td>Ensure client designates ‘reasonable’ salary per the IRS</td>
<td>If multi-member, members can deduct half of the total SE amount from their taxable income</td>
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<td>Potential to save substantial amount of taxes</td>
<td>Exception for members who are not in active operation of the business</td>
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Steps to Get Started
Choosing Which State to Incorporate In

Generally it’s best to incorporate in whichever state the business is located. Sometimes there’s an advantage to incorporating in a more “corporation friendly” state like Delaware, Nevada, or Wyoming.

- Nevada and Wyoming don't levy a state corporate income tax or a state personal income tax
- Delaware doesn’t have a corporate income tax for businesses formed there and no personal income tax on non-residents
- Delaware has separate court system for businesses and individuals
- Can’t escape home-state taxes
Steps to Incorporate a Business

- Comply with licensing and zoning laws
- Conduct a business name search
- Name a registered agent
- Draft Articles of Incorporation
- File Articles of Incorporation with the state
- Write up corporate bylaws
- Apply and obtain Federal Tax ID Number
- Start a corporate records book
- Hold your first board meeting
- Complete additional federal and state requirements
- Stay compliant annually by filing Initial/Annual Reports
Steps to Form a Limited Liability Company

- Choose a name
- File Articles of Organization
- Choose a registered agent
- Decide on member vs manager management
- Create operating agreement
- Apply and obtain Federal Tax ID Number
- Comply with other tax and regulatory requirements
- Out of state LLC registration if necessary and applicable
- Stay compliant annually by filing Initial/Annual Reports
Steps to Elect S Corporation Tax Status

- Entity must first be incorporated as a C Corporation or have filed as an LLC
- A C Corporation electing S Corporation status must submit and file IRS form 2553 signed by all shareholders
- An LLC electing S Corporation status must submit and file IRS form 2553 signed by all shareholders
- An LLC electing to be taxed as a C Corporation must submit and file IRS Form 8832 signed by all shareholders
Helpful Resources
CorpNet Partner Program

Offer Business Formation and Corporate Compliance services to your clients in all 50 states. Your Client. Your Brand. We do all of the work.

Reseller vs. Referral

Business Formation Guidance

Business formation decisions don’t have to be challenging. We provide easy to follow graphs and tables to guide you along the way.

Checklists, Guides, and Tools

- Dedicated account manager
- White label offering
- Onboarding and personalized support throughout program usage
- Worry free business filing and compliance monitoring
- Economical services for clients
- Proactive alerts and filing due dates from CorpNet’s online BIZ portal
- Easy access to view and print official documents.

Ongoing Partner Support