

Examining the Structure of how you do Business

By

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Most of us are the recipients of numerous sources of information pertaining to taxes and a number of newsletters cover tax topics. However, it is important to realize that tax planning is not a once in a year, do at the very end of year, transaction-by-transaction sort of endeavor. Rather, it is something that should be considered in every aspect of the way you do business and in addition, this basic structure of the business should always be considered from a tax perspective. Enclosed with this Article, is a table that compares and contrasts six forms of doing business. Each of them has advantages and disadvantages from a variety of perspectives including the tax perspective. It is important to realize that the appropriate entity of a given business should be looked at with great care. Recent studies suggest that all of these entities are viable and under the right circumstances can result in the lowest possible tax for an individual. Selecting the type of entity becomes critical and is heavily dependant on the facts and circumstances of a given situation. Notwithstanding the conventional wisdom, which by the way does change from year to year, all of these types of organizations have their place in a viable tax structure for a given individual. But which of these entities would be selected, is very much dependant on a number of factors.

One clear trend is demonstrated by the movement away from sole proprietorships that do not afford any protection from liability with respect to the business. However, a one member LLC will give you proprietorship tax treatment while preserving limited liability. Limitation of Liability and using Limited Liability entities to protect assets is becoming the number one way to safeguard property in a more and more litigious society.

A detailed analysis of the most recent tax data indicates that in fact "C" corporations, where the circumstances are correct, are the right choice of entity with respect to the form of organization for a business. As is always the case, it is important to examine with care the facts

and circumstances and tailor the entity to be selected carefully according to the needs of the business and the goals and objectives of its owners. Wolcott Rivers Gates can help you make these choices.

	Income Taxation	Liability	Self-Employment Tax	Deductibility Of Losses	Special Considerations
<i>Sole Proprietorships & One Member's LLCs</i>	Income is included on the owner's individual tax return.	The owner generally is not protected from liability. For LLCs see below.	The owner's net income is fully subject to self-employment tax.	If the owner actively participates, losses are fully deductible against other income. The owner may carry back or forward net operating losses.	Because business income or loss flow through to the owner's personal tax return, other items (such as deduction limitations) can be affected.
<i>Partnerships</i>	Income flows through to each partner's individual tax return.	General partners are subject to unlimited liability. Limited partners have liability to the extent of their investment.	General partners are subject to the tax on partnership income, but limited partners usually are not subject.	Generally, partners can deduct active partnership losses against other income, up to their basis, and passive losses only against passive income.	Income from a partnership is taxable regardless of whether partners receive an equivalent amount of cash as a distribution.
<i>Limited Liability Companies (LLCs)</i>	Recent check-the-box regulations have made qualifying an LLC for partnership taxation much simpler.	Members' liability is limited — similar to that of corporate shareholders.	Members are generally subject to the tax except those qualifying as limited partners had the entity been a limited partnership.	If an LLC is taxed as a partnership, the loss rules follow partnership rules.	Generally, LLCs have the flexibility of partnerships with the limited liability of corporations.
<i>S Corporations</i>	Income flows through to each shareholder's individual tax return. In some instances, taxation can occur at the entity level.	Shareholders' personal liability is limited.	Shareholders with income from their proportionate shares of company earnings are not subject to the tax.	Shareholders can deduct losses to the extent of their basis, but — unlike partnerships — shareholders' proportionate debt share does not increase their basis.	The maximum income tax rate (39.6%) is higher than for C corporations (35% once the lower graduated brackets are phased out).
<i>C Corporations</i>	C corporations are taxed on their earnings and shareholders are taxed on any dividends they receive.	Shareholders' personal liability is limited.	Does not apply.	As a separate taxpayer, corporations can deduct losses or carry them back or forward to offset income in profitable years.	Income can be subject to an alternative minimum tax of 20%.
<i>Virginia Small Business Trusts</i>	Partnership Taxation or Trust Taxation	Beneficial owners liability is limited	Similar to partnership if beneficial owner has no voice in management no SE tax	Treated like LLC's	Trustee controls entity beneficiary the analog of Limited Partners but with different and generally far lesser rights



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