Entity Tax Comparison

	Sole Proprietorship	Partnership	LLC	S Corporation	C Corporation
Who can own the company?	One individual owner	2 or more owners	Generally, one or more owners. However, some states require 2 or more owners	Shareholders limited to 75 and can only be individuals, certain trusts, and estates	No limit, however some states require a minimum of 2 shareholders
Is there limited liability?	No. Unlimited personal liability	General partners are personally liable for partnership debts. Limited partners are normally limited to their contribution	Yes. All members have limited liability	Stockholders are generally not liable for debts if corporate formalities are maintained	Stockholders are generally not liable for debts if corporate formalities are maintained
Who pays the Federal income tax?	Income and deductions are reported by individual on Schedule C (Form 1040). Separate Schedule C's are needed for each business	Partnership does not pay tax, but files a Form 1065 as an information return. Partners are taxed on their distributive share of income and deduction as shown on their Form K-1.	**Chameleon Rule** By filing Form 8832, an LLC can elect to be taxed as a: (1) tax nothing (e.g., a sole proprietorship if there is only one member), (2) partnership (if there are 2 or more members), or (3) corporation	If formerly a C corporation, there can be tax on built-in gains and passive investment income. Otherwise, a S corporation is not taxed, but only files a Form 1120S as an information return. Shareholders are taxed on income attributable to their stock ownership	Income is taxed twice. Once when earned by C corporation and again when distributed to shareholders as dividend. Corporation files Form 1120.
What is the maximum tax rate?	39.6%	39.6%	See"Chameleon Rule" above	39.6%	39% for the corporation and 39.6% for shareholders

What tax year can be used?	Same year as the individual owner	Restricted to tax year of majority partners, principal partners or calendar year	See"Chameleon Rule" above	With certain exceptions, must be calendar year unless IRS approves different year for business purposes	Calendar year or any fiscal year based on filing of first tax return
When is the income taxable?	Same year as the individual owner	Partners must report their share of partnership income in the year in which the partnership's tax year ends	See"Chameleon Rule" above	Shareholders must report their share of corporate income in the year in which the corporation's tax year ends. However, shareholders and corporation can be subject to estimated taxes	Based on corporation's taxable year. Corporation is subject to estimated taxes. Shareholders pay tax on dividends in the tax year received
How is income allocated to owners?	All to individual owner	According to the partnership agreement, which normally allocates based on profit and loss percentage.	See"Chameleon Rule" above	Pro rata based on share ownership determined on a daily basis, according to the number of shares held on each day of the corporation's tax year	All to corporation
What happens when you contribute property to the company?	Nothing - the owner and the company are one and the same	Not a taxable event, unless the property is mortgaged in excess of basis (§721)	See"Chameleon Rule" above	Taxable unless terms of §351 are met	Taxable unless terms of §351 are met
What is the character of the income when received by the owners?	Income retains its characteristics	Income retains its characteristics	See"Chameleon Rule" above	Income retains its characteristics	All income characteristics are lost on distribution of income to shareholders

How are net operating losses allocated?	All to individual owner	According to the partnership agreement, which normally allocates based on profit and loss percentage	See"Chameleon Rule" above	Pro rata based on share ownership determined on a daily basis, according to the number of shares held on each day of the corporation's tax year	All to corporation
How much loss can owner deduct?	Capital investment plus debt	Partner's capital investment plus share of partnership debt	See"Chameleon Rule" above	Shareholder's capital investment plus shareholder loans to corporation	Owner is corporation. Shareholders are not entitled to deductions
Do the "at-risk" rules apply?	Yes, but individual has an indefinite carryover of excess losses	Yes, but partners have an indefinite carryover of excess losses	See"Chameleon Rule" above	Yes, but shareholders have an indefinite carryover of excess losses	Yes, if closely held, but corporation has an indefinite carryover of excess losses
Do the passive loss rules apply?	Yes	Yes	See"Chameleon Rule" above	Yes	Yes, for closely held and personal service corporations
What happens if earnings are retained?	Taxed to the individual owner	Taxed to the partners, but increases basis in partnership interest	See"Chameleon Rule" above	Taxed to the shareholders, but increases stock basis	Taxed to corporation and subject to accumulated earnings tax penalty
Are nonliquidating distributions taxable to owners?	No	No, unless money distributed exceeds partner's basis. Section 751 assets can cause gain to be ordinary	See"Chameleon Rule" above	No, unless distribution exceeds shareholder's stock basis or AAA. Accumulated earnings and profits can cause dividend treatment	Yes, to extent of earnings and profits or if distribution exceeds stock basis

Is the distribution of appreciated property taxable to the company?	No	No	See"Chameleon Rule" above	Yes, but recognized gain is passed through to shareholders	Yes
What can be done to split income among family members?	Employ children	Employ children; gift or sell partnership interests subject to certain limitations and "kiddie backfire" tax	See"Chameleon Rule" above	Employ children; gift or sell stock but watch out for "kiddie backfire" tax. Adjustment can be required to adequately reflect compensation for services	Employ children; gift or sell stock but watch out for "kiddie backfire" tax
How are organizational expenses reported?	Amortized over 60 months	Amortized over 60 months	See"Chameleon Rule" above	Amortized over 60 months	Amortized over 60 months
How is capital gain taxed?	To the individual owner	Passes through and is taxed to partners	See"Chameleon Rule" above	Except for certain penalty taxes, it passes through and is taxed to shareholders	To corporation using regular corporate tax rates
How are capital losses reported?	Owner can annually use $3,000 of capital losses against ordinary income. Balance is indefinitely carried over	Pro rata by partners	See"Chameleon Rule" above	Pro rata by shareholders	Deductible by the corporation but only to the extent of capital gain. Balance can be carried back 3 years and forward 5 years
How are §1231 gains and losses reported?	Owner is taxed on gains and can deduct losses subject to 5 year lookback rule on losses	Pro rata by partners	See"Chameleon Rule" above	Pro rata by shareholders	Corporation is taxed on gains and can deduct losses subject to 5 year lookback rule on losses
How is the alternative minimum tax reported?	Taxed to the individual owner at a 26% to 28% rate	Pro rata by partners	See"Chameleon Rule" above	Pro rata by shareholders	Taxed to the corporation at a 20% rate and subject to the ACE adjustment

Is §1244 treatment available?	No	No	See"Chameleon Rule" above	Yes	Yes
Is there a potential built-in gains tax?	No	No, unless partner contributed property with a basis different than its FMV in which case the built-in gain or loss will be allocated to the contributing partner under §704(c)	See"Chameleon Rule" above	Yes, if formerly a C corporation. However, built-in gain or loss on contributed property is not allocated to the contributing shareholder but pro rata to all shareholders	No, unless later converted to a S corporation. Built-in gain or loss on contributed property is not allocated to the contributing shareholder.
Are special allocations permitted?	No	Yes, if they have substantial economic effect	See"Chameleon Rule" above	No	No
Do company liabilities increase the owner's basis?	Yes	Yes, they increase the partner's basis in his partnership interest?	See"Chameleon Rule" above	No	No
Are fringe benefits widely available?	No	No	See"Chameleon Rule" above	No, especially for 2% or greater shareholders	Yes