

Lifecycle of a Family Business Owner

The Early Years



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Formation of Microsystems in 1976



- Options - C corp, S corp, LP, GP
- LLC structure not available
- Pre-TRA of 1986 - most businesses opted for C corp

Outline pp. 1-15

Formation of Microsystems in 2010

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- Corporation – C corp and S corp
- Partnership – GP, LLP, LP and LLLP
- LLC

Outline pp. 1-15

Formation of Microsystems in 2010

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- **LLC favored if formed in 2010:**
 - **Single level of tax**
 - **No single class of stock requirement**
 - **No restrictions on owners**
 - **Debt increases basis**

Outline pp. 11-15; 33-37

Formation of Microsystems in 2010

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- **LLC favored if formed in 2010 (cont'd):**
 - **Greater flexibility in the allocation of income and loss items**
 - **IRC § 754 election**
 - **Microsystems could convert to a C corp in the future on a tax-free basis**
 - **Additional advantages to be discussed**

Outline pp. 33-36; 44-45; 113-14

When to Consider Alternatives to the LLC

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- **Small companies**
 - **First \$50K in C corp earnings is taxed at 15%**
 - **Self-employment tax issues**
- **Professional services organizations**
- **Start-ups with investors who'd rather accumulate losses at corporate level to offset against future gains**

Outline pp. 2; 37-41; 33

State Law Issues

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- Fiduciary duties of LLC member/managers vs. corporate officers and directors
- Creditor protection

Outline pp. 29-30

Self-Employment Tax

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- Employer and Employee FICA together
- 15.3% on first \$106,800
- 2.9% on balance

Outline pp. 37-41

Self-Employment Tax, cont'd

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- Partners in partnerships
- S corp unreasonable compensation issue
- Trade or business income only

Outline pp. 37-41

Self-Employment Tax, cont'd

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- Real estate in separate LLC
- Deduct rent from main LLC's Self-Employment income
- Rent not subject to Self-Employment tax

Outline pp. 37-41

Self-Employment Tax, if Large

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- Each owner forms a separate S corp
- Don't run compensation through S corp
- Use for entity profits

Outline p. 41

Incentive Compensation

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- S corps may provide incentive compensation without violating second class of stock rule

Outline pp. 9-11

Incentive Compensation

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- Advantages of partnership profits interests
 - No income tax on issuance
 - Performance-based
 - May avoid minority shareholder issues
 - Section 409A

Outline pp. 21-29

Split Ups – Corporate Redemptions

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- Historically – goal is exchange treatment v. dividend treatment
- IRC § 301 – dividend treatment is general rule
- Two Exceptions
 - IRC § 302
 - IRC § 303
- S corp – favors distribution treatment

Outline pp. 73-77

Split Ups – Partnership Redemptions

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- IRC § 731(a), (b) – distributions of money are tax-free to the extent of basis
- Two Exceptions
 - IRC § 701(c)(1)(B)
 - IRC § 737
- IRC § 736 – characterization of gain on redemption

Outline pp. 104-09

Split Ups – Corporate v. Partnership Division

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- Corporate Division – may be tax-free under IRC § 355 if 7 part test satisfied.
- Partnership Division – generally tax-free per IRC § 708(b)(2)(B)

Outline pp. 80-103; 112-13

Nonvoting Recaps of S Corps

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- 99/1 recap v. 95/5 recap
- *Estate of Simplot*, 112 T.C. 130 (1999), rev'd 249 F. 3d 1191 (9th Cir. 2001)

Outline pp. 6-7

C Corp Triple Taxation

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Business Operations (\$208)

- (Tax: $\$208 \times 40\% = \83)

Corporation (\$125)

- (Tax: $\$125 \times 20\% = \25)

Shareholder (Purchaser) (\$100)

- (Tax: $\$100 \times 20\% = \20)

Seller (\$80)

Outline p. 49

S Corp Double Taxation

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Business Operations (\$167)

- (Tax: $\$167 \times 40\% = \67)

Shareholder (Purchaser) (\$100)

- (Tax: $\$100 \times 20\% = \20)

Seller (\$80)

Outline p. 50

Partnership Single Taxation of Goodwill

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Partnership (\$133)

- (Tax: $\$133 \times 40\% = \53)

Selling Partner with
Limited Retained
Preferred Profits
Interest (\$80)

Outline p. 51

Holding Company Rules

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- More clearly defined rules for corporations rather than partnerships
- IRC 6166

Outline pp. 85-86

Potential Patent Tax Issues

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- Generally if patents are going to be a large part of company assets, partnership structure is preferable to corporation

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