US Business Entities

Moderator: Michael Lang
Panelists: Mona Hymel, Richard Lipton, Roberta Mann, Walter Schwidetzky
Partnerships

- Advantages:
  - Single Level of Tax to Partners
  - Partnership Debt Included in Partners' Bases
  - Liability Shield Possible
Partnerships

- Advantages Continued
  - Special Allocations
  - Section 754 Election
  - Contributions and Distributions
  - Service Partners
Partnerships

- Disadvantages:
  - Liability if Stupid, Elect LLP Status
  - Management Default Rules Under RUPA
  - Mutual Agency
  - Transfers Difficult (Could be Advantage)
  - Dissolution Triggers
  - Audit Rules
Mixing Bowl Rules.

Section 704(c)

Partnership/LLC Agreements Don’t Have to be Complicated, But Partnership Tax Should be Thought of as Always Complicated

- Even if the Current Deal is Straight-Forward, There is Always Downstream Potential
C-Corporation

- Advantages:
  - Liability Protection
  - Transfers
  - Reorganizations
  - Administration Centralized
  - Lower Corporate Rates
C-Corporation

- Advantages continued:
  - Control
  - Different Classes of Stock
  - Ordinary Losses Allowed on Section 1244 Stock
  - Section 1202. If Available, Can Tip the Scale in Favor of C corporation Status
C-Corporations

- Disadvantages:
  - Double Taxation
  - Corporate Losses
  - Net Operation Losses
  - Formalities
  - Contributions and Distributions
  - Service Providers
  - Complexity
Notwithstanding new 21% Corporate Income Tax Rate, Usually Still Better to be a Passthrough if Closely Held

- IRC 199A Important in This Regard.
- Tax Rate Unlikely to Decrease But Could Increase Substantially
Of Course, There are Exceptions. Examples:

- IRC 1202 Applies

- Joint Venture Capitalists Often Prefer to take Convertible Preferred in a C corporation
S-Corporation

- Advantages:
  - Still a Corporation. Still has Most State Law Advantages if Incorporate
  - Single Level of Tax and Flow Through of Losses (Usually)
  - Ordinary Losses Allowed on I.R.C. § 1244 Stock
  - Public Offering Simpler if State-Law Corporation Than if Start with Tax Partnership
Advantages Continued:

- Self-Employment Taxes, Likely Most Common Reason S corporations are Used
- Most S corporations have 2 or fewer shareholders
Real Estate Development with Appreciated Property. “Capital Gain Freeze” Technique

- Bankruptcy Versus Partnership
- No Section 704(c) or 751 Analog
- Generally, Simpler than Partnership Tax
S-Corporation

Disadvantages:

- Qualification Requirements (Shareholders cannot be C-corporations or Nonresident Aliens)
- Tax Differences with Partnerships
  - Contributions and Distributions
  - One Class of Stock Limitation
  - Allocations
  - Liabilities
Possible Taxation at Entity Level if Prior C Corporation

Debt-Financed Proceeds

Etc.
Limited Liability Company

- Default Rules: One-Member Disregarded, 2+ Partnership
  - May Elect S or C corporation Status
  - If Want S corporation taxation, Common to Use LLC and Elect S corporation Status
Advantages:

- Most Partnership Advantages if Under Default Rules
- Liability Protection
- Simplicity/Lack of Formalities
- Creditor Protection (Multiple/One-Member LLCs)
- Modern Statutory Architecture
Limited Liability Company II

- Disadvantages:
  - Most Partnership Disadvantages if Under Default Rule
  - Interstate Transactions
  - Lack of Uniformity/ Law Developing/But RULPA Getting Traction
  - State Taxation
  - Pre-Acquisition Investigation
Domestic Partnership/LLC Returns by Type of Partnership, 1990-2014
Source: IRS
Number of C Corporation Returns Compared to the Sum of S Corporation and Partnership Returns 1978-2005
Domestic Partnership Returns by Type of Partnership, 1989-2005
Figure 4.—Business Returns by Type of Entity, 2014

Source: JCT staff calculations on IRS Statistics of Income data.