TAX YEAR
2023

Business Entity Pros and Cons

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Business Entity Pros and Cons

Sole Proprietorship	
Pros	• No formal creation process. • Easy to operate and dissolve. • No separate tax return. • Easy to integrate business use of home deductions. • No double taxation of profits.
Cons	• No liability protection, except through insurance. • Self-employment tax is assessed on entire net profit of the business. • Transfer of ownership can be complex. • Limited access to fringe benefits for owners.
Good Fit	• Seasonal or part-time businesses. • Businesses with little liability. • Home-based businesses. • Businesses intended to operate for the owner's life only.

Single-Member LLC	
Pros	• Simple creation process. • Easy to operate and dissolve. • No separate tax return. • Easy to integrate business use of home deductions. • Liability protection for member, except for malpractice. • No double taxation of profits.
Cons	• Self-employment tax is assessed on entire net profit of the business. • Transfer of ownership can be complex. • Limited access to fringe benefits for owners. • Laws regulating LLCs vary widely among states.
Single-Member LLC continued	
Good Fit	• Businesses with potential liability in operations. • Businesses intended to operate for the owner's life only.

Multi-member LLC	
Pros	• Simple creation process. • Limited liability for all members, except for malpractice or debt guarantees. • Unlimited number of members. • Separate entity from members, allowing for greater flexibility in operations. • Ownership is in the form of membership interest and can be transferred more easily than ownership in a single-member LLC. • No double taxation of profits.
Cons	• Requires a separate tax return. • Laws regulating LLCs vary widely among states.
Good Fit	• Businesses requiring equity capital. • Businesses with potential liability in operations. • Businesses intended to exist beyond the lives of the members. • Businesses expecting changes in ownership over time.

General Partnership	
Pros	• Simple creation process. • No limit on partner number or type. • Can be used to hold investments in other businesses and consolidate multiple lines of business. • Flexible allocation of profit, loss, and distributions. • Favorable tax treatment when liquidated. • No double taxation of profits.
Cons	• Requires a separate tax return. • Unlimited liability for all partners. • Difficult to dissolve or change ownership without substantial planning. • Requires tracking of basis for partners, both inside and outside the partnership. • Individual partner's share of income is subject to self-employment taxes.
Good Fit	• Two established businesses who wish to work as one. • Partners wishing to consolidate multiple entities into one entity.

Business Entity Pros and Cons

Limited Liability Partnership	
Pros	• Simple creation process. • Liability protection for limited partners. • Separate entity from partners. • Ownership can be transferred within the rules of the partnership agreement. • Limited partners' liability is limited to their investment in the business. • Limited partners pay self-employment tax on guaranteed payments only. • No double taxation of profits.
Cons	• Must have one general partner with unlimited liability. • Limited liability status for damages can be lost for a variety of administrative reasons. • Restrictions on partners based on entity type. • Requires a separate tax return. • Requires tracking of basis for partners, both inside and outside the partnership.
Good Fit	• Businesses with partners not actively involved in business. • Businesses with equity capital needs. • Businesses with exposure to liability.

C Corporation	
Pros	• No liability for non-active stockholders. • No restrictions on ownership. • Ownership can be transferred through the sale of stock. • Separate entity from stockholders. • Fringe benefits for owner-officers. • Can have ownership interest in any other business entity. • Perpetual existence. • Raising capital can be achieved by issuing stock.
Cons	• Double taxation of profits. • Complex and expensive to create and maintain. • Requires regular board of directors' meetings and minutes. • Requires a separate tax return.
Good Fit	• Businesses with ownership in multiple other entities. • Businesses with significant exposure to liability. • Businesses intended to exist eternally.

S Corporation	
Pros	• Liability protection similar to that of C corporations. • No double taxation of profits. • Ownership is easily transferred through the sale of stock. • Separate entity from stockholders. • Self-employment tax is not assessed on the entire net profit of the business. • Losses can offset shareholders' other taxable income.
Cons	• Complex and expensive to create and maintain. • Requires a separate tax return. • Requires regular board of directors' meetings and minutes. • Requires tracking of basis for stockholders. • Ownership is limited to specific types of entities. • Deductibility of fringe benefits for owner-employees is limited.
Good Fit	• Businesses with significant exposure to liability.

Business Formalities

A common issue with a closely-held business is failure to adhere to business formalities. Trouble can occur when business and personal funds are intermingled, the business is not adequately capitalized, or reasonable compensation for services is not paid.

For example, separation of funds can be a key in preserving the liability protection of the "corporate veil." Courts can pierce the corporate veil if they find the corporation is an "alter ego" of the shareholder, which is likely to occur if shareholders pay personal expenses from the corporation checkbook or vice versa.

Transactions such as capital contributions or loans between the business and the owners can also be recharacterized by the IRS, creating unexpected negative tax consequences.

Contact Us

There are many events that occur during the year that can affect your tax situation. Preparation of your tax return involves summarizing transactions and events that occurred during the prior year. In most situations, treatment is firmly established at the time the transaction occurs. However, negative tax effects can be avoided by proper planning. Please contact us in advance if you have questions about the tax effects of a transaction or event, including the following:

- Pension or IRA distributions.
- Significant change in income or deductions.
- Job change.
- Marriage.
- Attainment of age 59½ or 73.
- Sale or purchase of a business.
- Sale or purchase of a residence or other real estate.
- Retirement.
- Notice from IRS or other revenue department.
- Divorce or separation.
- Self-employment.
- Charitable contributions of property in excess of $5,000.

This brochure contains general information for taxpayers and should not be relied upon as the only source of authority. Taxpayers should seek professional tax advice for more information.

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