4 Major Business Entities:

Sole Proprietorship: self-employed individual who operates a trade or business where all the tax consequences fall to that individual, including all liabilities, debts, profits and losses.

Partnership: organization made up of two or more participants who carry on the business together. They allocate the ownership and profit/loss aspects according to their specified contractual terms. This partnership is separate entity for tax filing purposes, but not tax paying.

Corporation: A separate, legal entity formed through a state charter using articles of incorporation. It is authorized to perform primarily all the business activities an individual can, including taxes (filing & paying), signing contracts, and creating loans. Corporations are formed through the issuance of stock or securities. There two main types.

Regular "C' Corp: taxed separately from its owners.

Subchapter "S" Corp: do not pay any income taxes. Instead, the corporation's income and losses are divided among and passed through to its shareholders. The shareholders must then report the income or loss on their own individual income tax returns.

Limited Liability Company (LLC): a hybrid with some features of a partnership and the limited liability of a corporation to qualify as an LLC, the business can not have at least two main components of a corporation: continuity, centralized management, transfer of ownership. The two most significant features of an LLC are that it affords the partners a degree of limited liability protection but still acts as a conduit of regular partnership. Not available in all state though most allow it.

Liability of Owners.

SP: unlimited liability for business actions
P: unlimited liability for business actions
Corp: may be limited to assets
LLC: may be limited to assets

Income/Losses:

SP: taxable to individual proprietor
P: taxable to partners
Corp: C-corp taxable to corporation; S-corp: taxable to shareholders
LLC: taxable to partners

Existence of Business:

SP: ends with death of proprietor
P: ends with death, bankruptcy of partners or more than 50% of ownership
Corp: indefinite
LLC: may end with death, bankruptcy of partner, change of ownership

Transferability:

SP: easy
P: may require approval from partner
Corp: easy unless restricted by agreement terms
LLC: may require approval from partner

Tax Year:

SP: individuals tax year, usually on a calendar basis
P: usually calendar year
Corp: calendar or fiscal for most C, MUST be calendar for S
LLC: usually calendar year

Ease of Setup:

SP: quite easy, no state charter or legal agreements
P: easy, but agreements are recommended, state & federal tax ids needed
Corp: most difficult and costly, paperwork and fees necessary
LLC: more difficult than a partnership, agreements recommended, state & federal ids required

Limits of Ownership:

SP: only one individual can own
P: no limit
Corp: no limit for "C" maximum; of 75 shareholders for "S"
LLC: no limit

Ease of Fund Shifts:

SP: quite easy, draw account used
P: easy; partner's draw or capital account used, but must be tracked
Corp: more complicated for deductibility purposes, liability protection, etc.
LLC: easy; partner's draw or capital account used, but must be tracked

Min. Requirements for Recordkeeping:

SP: easiest; no balance sheet requirements, no accounting to other owners/partners
P: fairly complicated if partners' capital accounts are tracked
Corp: complicated; balance sheet requirements, minutes of meetings, resolutions, other "arm's length" requirements to be met
LLC: fairly complicated, more so than regular partnership to keep qualifications as LLC intact

Management:

SP: centralized system with one sole owner
P: not centralized; partners' agreements are usually required
Corp: centralized with appointment by the board of directors
LLC: not centralized; partners' agreements are usually required

Qualifying Retirement Deductible Plan Availability:

SP: available
P: available
Corp: available
LLC: available

Passive Loss Deductibility:

SP: cannot offset ordinary business income
P: cannot offset ordinary business income
Corp: may be able to offset ordinary income for "C" types; cannot offset "Sub S" types
LLC: cannot offset ordinary business income

Double Taxation:

SP: no double taxation
Partnership: no double taxation
Corp: double taxation possibility for "C" type; no double taxation for "Sub S"
LLC: no double taxation

Possibility of Tax-Saving Family Income Splitting Techniques:

SP: possible, if owner is employing offspring, especially those under 18
P: definite possibilities to shift income to family members in lower tax brackets
Corp: limited for "C" type; but more possibilities for "Sub S" type
LLC: definite possibilities to shift income to family members in lower tax brackets

Fringe Benefits Deductibility:

SP: limited, especially in health, accident, life insurance, medical reimbursement, death benefits
P: Limited similar to sole proprietorship

Corp: more possibilities, especially for "C" types; some restrictions on "Sub S" types
LLC: limited similar to partnership or sole proprietorship

Ability to Retain Earnings to Defer Income to Owners:

SP: cannot retain earnings; taxable to owner in year posted
P: cannot retain earnings; taxable to partners in year posted whether or not they are distributed
Corp: "C" types can retain earnings up to certain limits; "Sub S" types cannot retain; they are taxable to the shareholders whether distributed or not
LLC: cannot retain earnings; taxable to partners in year posted, whether they are distributed or not

State Perspective; Legality:

SP: legal form of business in all states
P: Legal form of business in all states
Corp: "C" types recognized in all states; "Sub S" types not recognized for income tax purposes in all states, but recognized as a legal entity in all
LLC: not recognized similarly in all states, so formation, filings, and limited liability protection may be questionable especially if operations of business extend to multi-states

Tax Returns Filing:

SP: certain business schedules get included on individual 1040 form, but no independent, stand-alone return is filed
P: federal partnership Tax Return, Form 1065 must be filed
Corp: federal corporation Tax Return, Form 1120 for "C" type; Federal Form 1120S for "Sub S" type
LLC: similar to partnerships, unless chose to be taxed as a corp

Advantages/Disadvantages:

SP: this is usually the easiest type of entity to set up or terminate. Losses from the business can offset income from other sources. Management is totally centralized since there is only one legal owner. Recordkeeping may be a bit easier. Taking money out of the business is quite easy. However, there are some notable disadvantages, also: There is no way to "retain" earnings like other business forms; the owner has no limited liability protection; continuity and transferability of interest is limited; and certain deductible fringe benefits are not available as with other forms of business.

CORP: advantages include limited liability protection to owners, easy transferability of ownership, continuity even if original owners no longer exist, easier estate tax planning opportunities, more possible tax-free fringe benefit plans, and more flexible pension plans. In addition, it allows for a number of owners to participate. Obviously, there can be numerous advantages. The disadvantages can be equally as numerous. A corporation is usually more difficult and costly to set up or terminate. Much more planning is required to avoid double taxation issues. Recordkeeping can be quite complicated to preserve the limited liability feature. Taking money out of the corporation can also get tricky. Finally, tax return filings tend to be more involved.

P: if there is more than one owner, it is the easier of the entity types to set up. Active losses can be used to offset other income for the owners. Some degree of income tax and estate tax planning is possible since ownership percentages can be transferred fairly easily. The disadvantages are similar in scope to a sole proprietorship: No limited liability protection exists; the partnership usually ends upon the termination of a majority partnership interest, so continuity is limited; earnings cannot be retained, and tax-free fringe benefits are limited.

LLC: this entity has some of the better aspects of a partnership coupled with that of a corporation. It has limited liability protection yet allows for the "flow through" of income and losses to the partners so there is less chance for double taxation. Unlike the "Sub S" corporation with its limitations on the number of shareholders, and the type and status of these shareholders, there is much more flexibility here. Income and losses can be allocated more easily as well. However, the disadvantages center around the fact that these LLC's are still relatively new, and the states have varying rules and regulations concerning their operation, legal status, and degree of limited liability protection available. In addition, like a general partnership, tax-free fringe benefits are restricted. From a qualifying perspective on the federal level, there is always the possibility that the LLC will be challenged on its qualification. This could lead to a disastrous situation where it is re-classified as a corporation, and a double taxation event could occur.