

# Business Structuring



- ▶ Protect your assets
- ▶ Avoid double taxation
- ▶ Gain access to financing & capital
- ▶ Compensate owners

What is the most beneficial form of organization for your business? C corporation? S corporation? Limited liability company? Whether yours is a start-up or mature business, you need to periodically evaluate its structure to take advantage of the tax and nontax benefits available.

BKD can help provide the answers. We know the business and tax advantages and disadvantages of each option and can apply them to your business. And because changes in federal and state laws may affect the result, we'll help you evaluate your choice of entity as your business grows and changes.

## What are Your Choices?

Each of the following business structures has tax consequences. In addition, future transactions, such as a sale of the owners' interests, distributions to the owners or liquidation can be affected by the form of organization you select.

**Sole Proprietorship** - The simplest form of business because it involves only one owner who pays the company's income taxes and bears all business risks.

**General & Limited Partnerships** - Two or more persons who operate a business, share its profits or losses, pay its income taxes and bear its liabilities.

**C Corporation** - A legal entity that can insulate its owners from liability; both the corporation and its owners pay income taxes.

**S Corporation** - A legal entity much like a C corporation, but the owners pay income taxes.

**Limited Liability Company (LLC)** - A legal entity that can limit the owners' liability but may be treated as a partnership, corporation or a sole proprietorship for federal income tax purposes.

## Factors to Consider

There is no perfect solution when it comes to selecting a structure in which to conduct business. Some of the factors we'll help you consider include:

**Asset Protection** - How can you limit exposure to potential business liabilities so you are not personally liable? The C corporation, S corporation and LLC, when properly formed under state law, generally provide insulation from liability for owners.

**Double Taxation** - When planning an exit strate-

gy or a distribution of accumulated earnings from your business, how can you avoid the double tax trap?

Even though a C corporation can provide its owners with liability protection, the double tax trap can create significant problems down the road. Since the entity pays taxes on profits earned and the owners of the entity again pay taxes individually when those earnings are distributed, owners may find themselves paying as much as 45% to the federal government (60% after 2008).

The double tax trap becomes a significant issue when you try to sell or liquidate your business, take distributions from accumulated earnings or distribute appreciated property from the corporation. Plan now to avoid this trap in the future.

Several entity structures reduce the double taxation burden while still providing some or all of the other benefits you seek. These entities are commonly referred to as flow-through or pass-through entities because there is no entity-level tax; rather, as the owner, you pay tax on any income the business earns. Flow-through entities are general and limited partnerships, S corporations and LLCs.

**Expected Losses** - How can you take advantage of your company's tax losses, particularly to offset other income? The answer is a flow-through entity.

If your business expects losses in the start-up phase, and you materially participate in its activities, the losses generally "flow through" to you. However, you can only deduct the losses to the extent of your basis. If losses are funded by entity level debt, a partnership and LLC, rather than an S corporation, may increase your loss limit.

**Financing & Capital** - How do you plan to

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finance or capitalize your business? Will you seek outside financing? Who will borrow the money? Who will own the business or individual assets? Will you have outside investors? What entity is acceptable to your lender?

Answers to these questions could dictate the type of entity you choose. Discuss the proposed structure with your lender and investors early enough in the process to address questions and concerns they may raise.

**Ownership Flexibility** - How many owners and what type of owners will the business have?

Generally, an S corporation has the most restrictions on the type of owners; for example, owners are generally limited to individuals and certain types of trusts, no more than 100 shareholders and one class of stock. C corporations and LLCs, on the other hand, offer more flexibility.

**Owners' Compensation** - How will the owners be compensated for services rendered? Owners can only receive a "wage" in certain types of entities, yet must be paid a reasonable wage for services performed for a corporation or as a managing member of an LLC. S or C corporation owners may receive salary and dividends (within limits). Partners of a partnership are not paid a wage but receive a guaranteed payment.

**Fringe Benefits** - What tax-favored fringe benefits can an owner receive? A C corporation allows the most flexibility of tax-favored fringes, including

pensions, insurance and autos. In general, there are no tax-favored fringes allowed to most owners of pass-through entities.

**Self-employment Tax** - This tax generally applies to profits from sole proprietorships and partners of general partnerships and may apply to members of LLCs.

## BKD Solutions

The first step in selecting the right form of organization for your business is to list the factors of greatest importance to you. Are you most concerned about protecting your assets from liability? If so, a sole proprietorship or general partnership is not for you. If you want to avoid double taxation at all costs, a C corporation is not for you.

The table below lists some factors to consider and matches them with different entity selections. Once we know your priorities, we also can help you:

- Develop a business plan
- Evaluate the relative tax advantages and disadvantages of each entity choice
- Select the form of organization based on your objectives
- Work closely with your attorney and other advisors to meet your business objectives
- Provide tax planning and tax return preparation services
- Evaluate the tax implications of your selection on your succession and estate tax plans



## Beyond Your Numbers

BKD would like to take you beyond your numbers by applying our technical expertise, unmatched client service and disciplined delivery of solutions to your management and financial needs. We are committed to delivering results with integrity: solutions that are ethical, practical, timely and affordable. Let us take you beyond your numbers.



For a complete list of our offices and subsidiaries and their contacts, visit:

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Evaluating Business Structures						
	Sole Proprietorship	General Partnership	Limited Partnership	C Corporation	S Corporation	Limited Liability Company
<b>Asset Protection</b>	Minimal	Minimal	Limited	Yes	Yes	Yes
<b>Double Taxation</b>	No	No	No	Yes	No*	No
<b>Deduction of Losses by Active Owners</b>	Yes	Yes	Yes	No	Yes	Yes
<b>Organization Documents Required</b>	Few or none	Few or none	Yes	Yes	Yes	Yes
<b>Ownership Type</b>	Single member	2 or more individuals or other business entities	2 or more individuals or other business entities	No limit	Restricted number and type of owners	No limit

\* Certain exceptions apply