

“GABB Legal Minute: C-Corp, S-Corp or LLC, Choosing a Business Entity”
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Often clients ask me whether they should operate their businesses as sole proprietorships or form some sort of business entity. Today’s most common forms of business entities, where the owners and the business are separate for legal purposes, are corporations (the “c-corp”), subchapter-s corporations (the “s-corp”), and limited liability companies (the “LLC”).

Whether you elect to take advantage of the structure provided by a c-corp, s-corp or limited liability company depends upon several operational, legal and financial concerns. Here’s an overview of the general features of each:

C Corporations

A c-corp is an autonomous legal entity, existing apart from its owners, who are “shareholders.” Shareholders appoint “directors” who ensure the proper operation of the corporation. Directors appoint “officers” who perform day-to-day tasks in the operation of the corporation’s business. The corporation is considered to be a legal “person,” possessing most of the economic powers of a person: it can own property, sue in court, sell or transfer property, etc. A corporation has continuity of existence (an unlimited “life”), limited liability for investors, and the ease of adding investors and transferring ownership interests.

For tax purposes, c-corps lack “pass-through” tax treatment and incur double taxation. This means that the c-corp is taxed as an individual, filing its own annual income tax return at its own specified income tax rate. Distributions to its shareholders are taxed at the shareholder’s individual income tax rate. Larger businesses and those with significant corporate income will select the c-corp to prevent inclusion of large revenues on the owners’ personal income tax returns.

S Corporations

An s-corp is also an autonomous legal entity, existing apart from its owners, with shareholders, directors and officers responsible for the operation of the corporation’s business. The s-corp has the power to own property, sue in court, sell or transfer property, etc. While the s-corp has continuity of existence and limited liability for investors, its tax and ownership issues vary a bit.

A corporation can only elect and maintain s-corp status as long as it has no more than 75 owners; has U.S. citizens or foreign residents as shareholders (with minor exceptions); and has only one class of stock. Moreover, a corporation must affirmatively file an election to be an s-corp on or before March 15 of any calendar year or within the first 75 days after its formation.

The income and loss of an s-corp are attributed *pro rata* to its owners, regardless of whether any are actually distributed. This means that the s-corp has pass through taxation (*i.e.*, is taxed as a partnership), and there is no double taxation of corporate income. Also, the s-corp incurs lower tax rates than the c-corp, as s-corp income is typically taxed at the rate of the individual owner(s), rather than the higher corporate rate.

Limited Liability Company

The LLC is an autonomous legal entity, existing apart from its owners. Instead of shareholders, its owners are members. Members may operate the LLC directly, or they may appoint one or more individuals to serve as managing members to oversee the operations of the LLC. The LLC has the power to own property, sue in court, sell or transfer property; and offers limited liability for investors. The LLC has no absolute restrictions on the number or type of its owners. Moreover, an LLC may specify unique allocations of income and loss in its operating agreement. The continuity of existence of the LLC depends upon specific circumstances and the state in which the LLC is situated.

Like the s-corp, the income and loss of an LLC are attributed *pro rata* to its owners, meaning that it is taxed as a partnership. However, the IRS gives the members the option to elect taxation as a corporation. If that is not confusing enough, a single member LLC may be taxed as though the LLC does not exist (making it the ultimate “pass-through entity”).