

Choosing A Corporate Structure

The chart below sets forth the primary differences between the C-corporation, S-corporation and LLC so that a business owner can make an informed decision and choose the best corporate structure for his business.

| | C-corporation | S-corporation | LLC |
|--|--|--|--|
| Definition | An organization formed under state law. An artificial entity separate from its owners. | An organization structured legally like a corporation but taxed like a partnership. | An entity that can be taxed like a partnership but has limited liability like a corporation. |
| Who owns the business? | Shareholders | Shareholders | Members |
| Type of Ownership | Stock. There may be different classes of stock. | Only one class of stock, but there can be both voting and non-voting stock. | Membership interests, of which there may be different classes. |
| Personal Liability for Debts of the Business | No personal liability for shareholders, unless the corporate veil is pierced, except that the amount of their investment is at risk and to the extent they have personally guaranteed business debts or committed a personal tort. | No personal liability for shareholders, unless the corporate veil is pierced, except that the amount of their investment is at risk and to the extent they have personally guaranteed business debts or committed a personal tort. | No personal liability for members unless the veil is pierced, except that the amount of their investment is at risk and to the extent they have personally guaranteed business debts or committed a personal tort. |
| Eligible Owners | No restrictions. | 75 shareholder limit. No non-individual or non-resident shareholders, except an S-corporation can own another S-corporation. | No restrictions. |
| Management | Managed by director(s), who are elected by shareholders. Directors elect officer(s). | Managed by director(s), who are elected by shareholders. Directors elect officer(s). | All or a group of members, a designated managing member(s) or one or more designated managers. |
| Formation/Corporate Formalities | File Articles or Certificate of Incorporation with the Secretary of State. Prepare By-Laws, annual meetings, minutes and other corporate formalities. | File Articles or Certificate of Incorporation with the Secretary of State. Prepare By-Laws, annual meetings, minutes and other corporate formalities. Must file tax election with IRS within 75 days of date of incorporation. | File Articles of Organization with the Secretary of State, execute an Operating Agreement, prepare minutes, comply with publication requirements. |
| Income Tax | Double Taxation. Profits are taxed on the corporate level and then again on shareholder dividends. Income that would be taxed on the corporate level can be paid as salaries to employee shareholders to the extent the amounts are reasonable, creating a deduction for the business. | Flow-through Taxation. There is no tax on the corporate level. Income or loss is passed through to the shareholders. All profits are taxed even if not distributed. | Can be structured so that there is no tax at the entity level, with the income or loss passed through to the members like in an S-corporation or a partnership. |
| Withholding and Social Security Taxes | No self-employed tax or principals' wages or profits. Usual FICA and Medicare taxes on wages. | No self-employment tax on principals' wages or profits. Usual FICA and Medicare taxes on wages. | Principals must pay self-employment tax. Higher FICA taxes for principals. |
| Employee Benefit Plans | No restrictions. | No restrictions. | Principals not eligible for 401(k) plans. |
| Federal Tax Rates | Up to 35% | Up to 39.6% (individual tax rates apply) | Up to 39.6% (individual tax rates apply) |
| Duration | Perpetual | Perpetual | Can be Perpetual or any duration specified in the Operating Agreement. |
| Distribution of Funds | Dividends must be paid to shareholders based on the proportion of their stock ownership. Multiple classes of stock can be used to differentiate among classes of stockholders. | Dividends must be paid to shareholders based on the proportion of their stock ownership. | Profits can be distributed any way the Operating Agreement specifies, and do not have to be based upon the member's percentage of ownership. However, owners must be careful to comply with IRS regulations regarding partnership distributions. |
| Raising Capital | Sell shares. Can incur debt. | Sell shares. Can incur debt. | Possible to sell LLC membership interests, subject to the terms of Operating Agreement. Can incur debt. |
| Most Suitable For | Preferred corporate structure of venture capitalists, other investors, public companies and corporate subsidiaries. | Owners who want individual tax rates to apply to their business income. Preferred by smaller businesses that expect losses during the initial years of operation and for businesses that do not plan on going public. | Owners can decide what type of taxation they want for the business. Particularly beneficial for distributing profits in a disproportionate method to the capital contributed. Used a lot in small businesses and for real estate investments. |
| Securities Laws | The issuance or transfer of stock is subject to federal and state securities laws. | The issuance or transfer of stock is subject to federal and state securities laws. | The issuance or transfer of membership interest is subject to federal and state securities laws. |
| Costs | Filing fee with Secretary of State, annual franchise taxes, agent for service of process annual fee. | Filing fee with Secretary of State, annual franchise taxes, agent for service of process annual fee. | Filing fees, publication requirements, annual franchise tax, agent for service of process annual fee. |