Corporation vs. LLC – a comparison

All corporations start out as a **C Corporation**. Personal service C Corporations are taxed at a flat 35% on net profits, so this is not desirable for Personal Service Corporations. C Corporations that are not personal service corporation are tax at 15% on net profits. Most small to mid-size businesses then make an S Corporation election and become an "S Corporation" so they can avoid the corporate taxes. For purposes of this document when discussing corporations, we will be discussing S Corporations.

An **S corporation** is a corporation that makes a valid election to be taxed under Subchapter S of Chapter 1 of the Internal Revenue Code.

In general, S Corporations do not pay any income taxes. Instead, the corporation's income or 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. This concept is called *single taxation*; if the corporation is taxed as a C Corporation, it will face *double taxation*, meaning both the corporation's profits, and the shareholders' dividends, will be taxed.

A **Limited Liability Company** (abbreviated **L.L.C.**) in the law of the vast majority of United States jurisdictions is a legal form of business that provides limited liability to its owners. Often incorrectly called a "limited liability corporation" (instead of company), it is a hybrid business entity having certain characteristics of both a corporation and a partnership or sole proprietorship (depending on how many owners there are). An LLC, although a business entity, is a type of unincorporated association and is not a corporation. The primary characteristic an LLC shares with a corporation is limited liability, and the primary characteristic it shares with a partnership is the availability of pass-through income taxation. It is often more flexible than a corporation and it is well-suited for companies with a single owner.

It is important to understand that limited liability does not imply owners are always fully protected from personal liabilities. Courts can and do pierce the corporate veil of LLCs when some type of fraud or misrepresentation is involved, or under certain situations where the owner uses the company as an "alter ego."

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Federal Tax Planning S Corporation vs. LLC

Owners of businesses often inquire as to whether organizing as a Corporation or LLC offers any tax benefits. The following are some ideas on how a Corporation or LLC can be organized in a manner that gives a net tax savings. As with any taxation or legal issue, you should seek professional guidance before putting in place any of the ideas set forth here.

• Dividends and Profits Are Taxed at a Lower Rate Than Salaries . Corporations and LLCs can pay their owners partially in dividends (profit distributions) rather than ordinary income. Dividends are taxed at a maximum rate of 15%. Income, on the other hand is taxed at a maximum rate of 35%. A corporation or LLC owner can take of his or her company's profit in dividends rather than a salary, thereby reducing his or her tax burden. But the IRS is wise to the device, so you must check with your accountant first though, and you must pay yourself a reasonable salary before getting too generous with the dividends.

• Dividends and Profits Are Not Subject to FICA . Furthermore, dividend and/or profit distributions are not subject to the approximate 15% Social Security and Medicare taxes as salaries are. Again, the same warnings apply.

• Shift Personal Income into a C-Corporation. A C-Corporation pays only 15% on its first $50,000 of annual income. An individual, however, pays 25% to 38% on his or her personal income $31,851, as well as approximately 15% for FICA. And so, a C-Corporation owner in a high tax bracket can shift his or her first $50,000 of income into the C-Corporation, and can enjoy a significantly lower tax rate on that $50,000 of income. This works best in states with low income taxes. An accountant can help you calculate your tax savings accurately.

• Better Deductions for Losses. LLCs are not burdened by severe restrictions on operating and capital losses. Generally, losses can carry back 3 years, and can carry forward up to 15 years.

• Fewer Audits. Exact figures are disputed, but it is clear that the IRS conducts fewer audits on LLCs and corporations than it does on individuals.

• Medical Insurance. Corporations can enjoy greater tax deductions for medical insurance premiums paid for an owner-employee. Individuals can only deduct 60% of the premiums, while a Corporation can deduct 100% of the premiums.

• Higher 401K Deductions. Through a corporation or LLC, individuals can make higher contributions to 401K plans. Savings may be doubled with a corporate or LLC matching plan.

State of California Franchise Tax Planning S Corporation vs. LLC

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Here is a general rule of thumb found in a tax planning guide:

S corporations that are doing business in California must pay approximately 1.5% net income tax. LLCs are not subject to this tax, but must pay an entity-level fee based on gross receipts. If the business operates at a loss, the corporation form is generally preferable. If the entity operates at a profit, then the LLC may generally result in the lesser tax liability.

Now, let's look at this closer.

First, the S corporation. It must pay approx 1.5% net income tax ($800 minimum tax). (However the minim tax is waived the first year.) That means if the S corporation has a net income of $60,000 it would pay a tax of $900. Here is a chart to compare levels of tax:

Net Income	Tax Rate	Tax Due
$50,000	1.5%	$800 (minimum tax)
$75,000	1.5%	$1125
$100,000	1.5%	$1500
$150,000	1.5%	$2250
$200,000	1.5%	$3000
$300,000	1.5%	$4500
$400,000	1.5%	$6000
$500,000	1.5%	$7500
$800,000	1.5%	$12,000
$1,000,000	1.5%	$15,000

Now, let's compare this to an LLC in California:

LLCs in California taxed as partnerships must pay an entity level tax based on the "total income" reportable to California for the tax year. "Total income" means worldwide gross income, plus the cost of goods sold, paid or incurred in connection with the LLC's business. The following are examples (keep in mind these rates constantly change):

Total Income from all sources	Fee
Over $250,000, but less than $499,999	$900
$500,000 or more, but less than $999,999	$2,500
$1,000,000 or more, but less than $4,999,999	>$6,000
$5,000,000 or more	$11,790

Let's compare the S corporation and the LLC:

1. If you are in a business that has about $500,000 in gross sales and has about a 15% net profit margin (very good) that will equal $75,000 in net income.

If your business was an S corporation, the S corporation would pay a tax of $1,125. If it was an LLC it would pay a tax of $900 plus $800 in franchise tax, for a total of $1,700. In this example, the LLC would pay a higher over all fee.

Let's make some comparisons: (based upon a **15%** net profit margin) **for LLCs the minimum franchise tax is $800 per year.**

Gross Sales	Net Income	LLC Fees & Taxes	S Corporation Tax
$200,000	$30,000	$0 + $800 = $800	$800 minimum tax
>$275,000	$41,250	$900 + $800 = $1,700	$800 minimum tax
$600,000	$90,000	$2,500 + $800 = $3,300	$1,350
$900,000	$135,000	$2,500 + $800 = $3,300	$2,025
$1,200,000	$180,000	$6,000 + $800 = $6,800	$2,700
$6,000,000	$900,000	$11,790 + $800 = $12,590	$13,500

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Let's make some more comparisons: (based upon a **25%** net profit margin)

Gross Sales	Net Income	LLC Tax	S Corporation Tax
$200,000	$50,000	$0 + $800 = $800	$750
$275,000	$68,750	$900 + $800 = $1,700	$1,031.25
$600,000	$150,000	$2,500 + $800 = $3,300	$2,250
$900,000	$225,000	$2,500 + $800 = $3,300	$3,375
$1,200,000	$300,000	$6,000 + $800 = $6,800	$4,500
$6,000,000	$1,500,000	$11,790 + $800 = $12,590	$22,500

What can we conclude from this?

1. If your company has very high net profits, it will pay more tax with an S corporation. If your business has under $250,000 you will pay less tax at the STATE level as an LLC. But you may pay potentially more in SE taxes and therefore it would make overall more sense to be an S corporation.

2. If you are operating at a loss, an S corporation would make sense to a certain point. If you have a business generating $900,000 a year and have a loss, you may be much more protected in an LLC and it may be worth spending the $2,500 in LLC fees to gain that protection over an S corporation.

3. If you are going to be extremely profitable it would make more sense to be an LLC, ie, over $700,000 in net profits.

Side Note: A California Limited Partnership is only subject to a $300 flat tax.

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