

# **FIX IT STRATEGIES**

## **APPENDIX**

### **COMPARISONS AND EXAMPLES**

## CHOICE OF ENTITY

### Comparison of Characteristics of Partnerships (LLCs) and Corporations

<b>A. OPERATING CONSIDERATIONS--TAX</b>				
	<b>C CORPORATION</b>	<b>S CORPORATION</b>	<b>GENERAL PARTNERSHIP (LLC)</b>	<b>LIMITED PARTNERSHIP</b>
<b>1. INCOME SPLITTING ADVANTAGES – EXAMPLE 1</b>				
	Maximum income splitting available is <b>\$10,701</b> annually (not available to personal service corporations)	No income splitting is possible.	No income splitting is possible.	No income splitting is possible.
<b>2. INCOME SHIFTING POSSIBILITIES – EXAMPLE 2</b>				
	As income is taxed to the entity, no income shifting is possible without the payment of a double tax on dividend income.	As income is taxed to the owners of the shares, income shifting is possible.	As income is taxed to the owners of the shares, income shifting is possible.	As income is taxed to the owners of the shares, income shifting is possible.
<b>B. STRUCTURAL CONSIDERATIONS—TAX</b>				
	<b>C CORPORATION</b>	<b>S CORPORATION</b>	<b>GENERAL PARTNERSHIP (LLC)</b>	<b>LIMITED PARTNERSHIP</b>
<b>1. TAX CONSEQUENCES OF LIQUIDATIONS – EXAMPLE 3</b>				
a. Entity Corporation/ Partnership	43% tax on gain <sup>1</sup>	No tax	No tax	No tax
b. Owner Shareholder/ Partner	15% tax on gain.	15% tax on gain	No tax	No tax
c. Combined	56.1% tax on gain.	15% tax on gain.	No tax	No tax
<b>2. TAX CONSEQUENCES OF REDEMPTIONS – EXAMPLE 4</b>				
a. Entity Corporation/ Partnership	34% tax <sup>1</sup>	No tax	No tax	No tax

<sup>1</sup> 35% for income in excess of \$10,000,000

b. Owner Shareholder/ Partner	15% tax.	(1) The retiring shareholder will pay a 15% tax on any recognized gain.  (2) The remaining shareholders will incur a tax on the payments of 15%. The remaining shareholders will receive a basis increase equal to the before-tax income which will be deductible on sale of liquidation of the corporation	(1) No tax on property redemptions 28% tax on cash redemptions.  (2) No tax to remaining shareholders is possible (§ 736)	(1) No tax on property redemptions 28% tax on cash redemptions.  (2) No tax to remaining shareholders is possible (§ 736)
c. Combined	56.1% tax.	48.2% tax on <u>cash</u> redemption. 15% tax on <u>property</u> redemptions.	15% tax on <u>cash</u> redemptions. 0% on <u>property</u> redemptions	15% tax on <u>cash</u> redemptions. 0% on <u>property</u> redemptions
<b>3. BASIS CONSEQUENCES ON THE DEATH OF AN OWNER – EXAMPLE 5</b>				
	There is no increase in the basis of the entity's assets, only the shareholder's stock	There is no increase in the basis of the entity's assets, only the shareholder's stock	The assets of the partnership may be increased to fair market value	The assets of the partnership may be increased to fair market value

**EXAMPLE 1**  
**DOUBLE TAXATION**

	<b>C Corporation</b>		<b>Flow Thru* Individual/Owner</b>
<u>Entity</u>			
Income	\$100,000		\$100,000
Tax (34.00%)	<u>(34,000)</u>		<u>N/A</u>
	\$66,000		100,000
<u>Individual</u>			
Income	66,000		10,000
Tax (39.60%)	<u>(26,196)</u>	39.60%	<u>(39,196)</u>
NET CASH TO OWNER	<u>\$39,864</u>		<u>\$ 60,864</u>
<b>Benefit of single Level of Tax:                    <u><u>21,000</u></u></b>			

\* Flow-thrus include S Corporations, Partnerships and LLCs

**EXAMPLE 2**  
**INCOME SPLITTING ADVANTAGES**  
*(Assume: \$200,000 Worth of Income)*

	<b>C CORP</b>		<b>S CORP</b>
	<b>Corporation</b>	<b>Shareholder</b>	<b>Partnership, LLC or Sole Proprietor</b>
Taxable Income	\$100,000	\$100,000	\$200,000
Federal Income Tax	<u>(22,250)</u>	<u>( 22,404)</u>	<u>( 55,355)</u>
Net Cash	<u>\$ 77,750</u>	\$ 77,596	\$144,645
Net Cash to C Corp		<u>\$ 77,750</u>	<u>N/A</u>
Net Cash to Entity and Owner		\$155,346	<u>\$144,645</u>
Net Cash to S Corp.Sole Prop.		<u>(144,643)</u>	
INCOME SPLITTING ADVANTAGE OF C CORP		<u>\$ 10,701</u>	

### EXAMPLE 3

#### TAX CONSEQUENCES OF A LIQUIDATION

(Assume: \$1,000,000 in Value, \$0 Entity Basis, \$0 Owner Basis)

	<b>C Corporation</b>	<b>S Corporation</b>	<b>Partnership, LLC or Sole Proprietor</b>
<u>ENTITY LEVEL TAX</u>			
Value of Assets	\$1,000,000	\$1,000,000	\$1,000,000
Basis of Assets	_____ (0)	_____ (0)	_____ (0)
Gain	\$1,000,000	\$1,000,000	\$1,000,000
Federal Tax (34%)	_____ (340,00)	_____ (0)	_____ (0)
After Tax Net	<u>\$ 660,000</u>	<u>\$1,000,000</u>	<u>\$1,000,000</u>

<u>SHAREHOLDER/PROPRIETOR LEVEL</u>			
Liquidation Proceeds	\$ 660,000	\$1,000,000	\$1,000,000*
Basis	_____ (0)	_____ (0)	_____ (0)
Gain	\$ 660,000	\$1,000,000	NOT
Federal Tax (28%)	_____ (99,000)	_____ (150,000)	<u>RECOGNIZED</u>
After Tax Net	<u>\$ 561,000</u>	<u>\$ 850,000</u>	<u>\$1,000,000</u>

\* As this includes appreciated assets, there will be “deferred” gain/tax.

#### ADVANTAGE:

C Corp v. <u>S Corp</u>	N/A	\$244,800	N/A
C Corp v. <u>S.P.</u>	N/A	N/A	\$524,800
S Corp v. <u>S.P.</u>	N/A	N/A	\$280,000

### EXAMPLE 4

#### TAX CONSEQUENCES OF REDEMPTION USING APPRECIATED ASSETS

(Assume: Redemption Price \$1,000,000, \$0 Entity Basis, \$0 Owner Basis)

	<b>C Corporation</b>	<b>S Corporation</b>	<b>Partnership, LLC or Sole Proprietorship</b>
<u>ENTITY LEVEL</u>			
Value	\$1,000,000	\$1,000,000	\$1,000,000
Federal Tax (34%)	<u>(340,000)</u>	<u>N/A</u>	<u>N/A</u>
After Tax Net	<u>\$ 660,000</u>	<u>\$1,000,000</u>	<u>\$1,000,000</u>
<u>SHAREHOLDER/PROPRIETOR LEVEL</u>			
Pass-Thru Income	N/A	\$1,000,000	N/A
Federal Tax	---	<u>(280,000)</u>	<u>See Below</u>
Redemption Proceeds	\$660,000	\$1,000,000	\$1,000,000
Basis	<u>None</u>	<u>(\$1,000,000)</u>	<u>None</u>
Gain on Redemption	\$660,000	0	\$1,000,000
Federal Tax (28%)	<u>(184,800)</u>	<u>N/A</u>	<u>(280,000)</u>
<u>TOTAL TAXES PAID</u>			
Entity	\$340,000	0	0
Owner-Seller	<u>184,800</u>	<u>280,000</u>	<u>280,000</u>
Total Taxes Paid	<u>\$524,800</u>	<u>\$280,000</u>	<u>280,000</u>

#### ADVANTAGE:

C Corp v. <u>S Corp</u>	N/A	\$244,800	N/A
C Corp v. <u>S.P.</u>	N/A	N/A	\$244,800
S Corp v. <u>S.P.</u>		N/A	N/A

### EXAMPLE 5

#### TAX CONSEQUENCES OF AN OWNER'S DEATH OR THE PURCHASE OF AN INTEREST

(Assume: Value of Inventory at Date of Death is \$1,000,000)

	<b>C Corporation</b>	<b>S Corporation</b>	<b>Partnership, LLC or Sole Proprietorship</b>
Gross Entity Sales	\$1,000,000	\$1,000,000	\$1,000,000
Less: Entity Basis (34%)	<u>(0)*</u>	<u>(0)</u>	<u>(1,000,000)**</u>
Gain	<u>\$1,000,000</u>	<u>\$1,000,000</u>	<u>\$ (0)</u>
Federal Tax	<u>(\$ 340,000)</u>	<u>(396,000)</u>	<u>\$ (0)</u>

#### ADVANTAGE:

C Corp v. <u>S Corp</u>	\$56,000	N/A	N/A
C Corp v. <u>S.P.</u>	N/A	N/A	\$340,000
S Corp v. <u>S.P.</u>		N/A	\$396,000

\* There is no increase in the basis of the entity's assets, only the shareholder's stock.

\*\* Basis of assets increases to fair market value on death.