Comparison of LLC, S corporation, and C corporation

Comparison of LLC (Taxed as a Partnership), S Corporation, and C Corporation

Issue	LLC	S corporation	C corporation
Owners	Unlimited number of members; should not register in California as an LLC if providing professional services	Limited to 100 shareholders; cannot be foreign; only individuals and certain trusts	Unlimited
Who pays tax?	Income/loss flows to shareholder	Income and loss flows to shareholder; California tax of 1.5% of net income	C corporation pays tax at graduated rates of federal: 15–35% (personal service pays at 35%), California: 8.84%
California taxes	$800 annual tax + annual fee $0 to $11,790	Greater of $800 minimum tax or 1.5% of net income	Greater of $800 or 8.84% of net income
Affects of HI taxes 0.9% additional FICA & 3.8% surtax on investment income	In general, managing member subject to 0.9% tax on income subject to SE; subject to 3.8% tax on interest, dividends, and other income passed through; Nonmanaging member not subject to SE tax subject to 3.8% investment surtax on investment income	In general, active shareholder/ employee subject to 0.9% tax on wages; not subject to either tax on ordinary income passed through from S corporation; subject to 3.8% tax on interest, dividends, and other income passed through. Passive shareholder subject to 3.8% tax on net investment income	Dividends are investment income subject to the 3.8% surtax
Suitability to hold investments	Individuals pay tax at reduced capital gains and dividend rates	Possible tax on net passive investment income if previously a C corporation	Double tax on distributions — no reduced federal capital gains
Tax year	Same as members unless elect IRC §444 (maximum three month deferral) or qualify as natural business year	Same as members unless elect IRC §444 (maximum three month deferral) or qualify as natural business year	Generally any year except if a personal service corporation
Basis and at risk issues	Member's share of LLC liabilities plus loans guaranteed by member are part of basis	Guaranteed loans do not increase basis. Shareholder's basis is stock basis plus loans made by shareholder	N/A
Inherited basis	Beneficiary may make IRC §754 election and receive step up in assets	Stock basis receives step up, but S corporation assets do not receive step up (**Note:** 2010 estates may use modified carryover basis)	Stock basis receives step up, but C corporation assets do not receive step up (**Note:** 2010 estates may use modified carryover basis)
Compensation	Members are never employees. Managing and working members are subject to self-employment tax on guaranteed payments and ordinary income	Must take reasonable compensation as wages subject to payroll taxes; net income may be subject to self-employment tax for PSC	Must take wages subject to payroll tax; reasonable compensation issues
Medical insurance and long-term care	Not deductible by LLC — above-the-line deduction for member	Included in wages of >2% shareholder — above-the-line deduction (see IRS Notice 2008-1)	Deductible from C corporation income — not included in W-2 provided insurance is nondiscriminatory (employees are covered)
Medical reimbursement plan	Not available to member	Not available to >2% shareholder	Deductible by C corporation — not included in W-2
Disability and life insurance	No deduction for disability of life insurance paid for LLC member	Disability not available to >2% shareholder; life insurance not available to S corporation shareholder	Disability and up to $50,000 in premiums deductible for shareholder if employees are covered

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Charitable contributions	Flow through to member	Flow through to shareholder — up to 10% of taxable income deductible by CA corporation	Deductible by C corporation — limited to 10% of taxable income
Capital gains and losses	Flow through to member	Flow through to shareholder; treated the same as C corporation for California S corporation tax	No reduced capital gain rate; losses carried back three years and forward five years for federal and forward five years for California
Selling the entity	Sale of membership interest is capital gain/loss; may be subject to IRC §751 ordinary treatment	Sale of stock is capital gain/loss; may qualify for IRC §1244 loss	Sale of stock is capital gain/loss; may qualify for IRC §1244 loss or IRC §1202 small business gain exclusion (R&TC §18152.5)
Liquidating the entity	Gain flows to owner; tax on gain but not on distribution (gain increases basis)	Gain flows to owner; generally no federal tax on gain (gain increases basis) California S corporation tax at 1.5% rate	Corporate tax on gain; tax on distribution in excess of basis (no increase in stock basis due to gain)
Distribution of assets in complete liquidation	No tax except to the member if cash exceeds basis; member pays tax when assets are sold	Gain reported as though assets sold at FMV; gain flows to owner California S corporation tax at 1.5% rate	Corporate tax on gain as though assets sold at FMV; tax on distribution to shareholder in excess of basis
Distributing profits	May make unequal distributions	Must make *pro rata* distributions of profits	May have more than one class of stock so distributions not necessarily equal
Incentive stock options	Not allowed	Not allowed	Allowed
Small business stock exclusion	Not applicable	Not applicable	Noncorporate investors exclude gain up to 50%/100% federal
IRC §1244 loss	Loss on sale of LLC interest is treated as sale of a capital asset limited to $3,000 current loss in excess of gains	If qualified, individual taxpayer shareholders may claim up to $50,000 ($100,000 MFJ) as an ordinary loss in the current year upon sale, exchange, or worthlessness	If qualified, individual taxpayer shareholders may claim up to $50,000 ($100,000 MFJ) as an ordinary loss in the current year upon sale, exchange, or worthlessness
Restrictions	Nonmanaging members may be restricted in sale of interest; have no authority to manage	Only one class of shareholder allowed so no restrictions on selling shares; all shareholders have voting rights	May have more than one class of stock; some can be nonvoting
Single owner	A single-member LLC is a disregarded entity, meaning the income and losses are reported on the member's return; the member may have additional liability exposure	No difference from multiple owners	No difference from multiple owners
Passing interest to children	Children, even if working in the business, can be restricted from selling their interest; there is creditor protection with an LLC	Children who are shareholders may sell their shares and have whatever minority rights are available under state law; shareholders do not have creditor protection	Children can be issued different classes of stock; shareholders do not have creditor protection
Ownership change	Multiple returns	One return; multiple K-1s	One return
Technical termination	Multiple returns	One return; multiple K-1s	One return
Adding members	No gain	Gain if contribution of assets; wages if services in exchange for stock	Gain if contribution of assets; wages if services in exchange for stock