

Appendix 1

Comparison of Corporate and Noncorporate Attributes

Explanation: This table illustrates the differences between operating a business as an S corporation, C corporation, proprietorship, partnership, or LLC.

Attribute	S Corporation	C Corporation	Proprietorship	Partnership	LLC <sup>1</sup>
Continuity of life	Indefinite; but stock ownership must be monitored	Indefinite	Ceases on death of proprietor	Terminates if 50% or more of total interest in capital and profits is sold or exchanged within a 12-month period	Generally no; but available in some states. Terminates for federal taxes if 50% or more of capital and profits interests are transferred during a 12-month period
Transferability of interests	Generally freely transferable; can be restricted through buy/sell agreements; must observe limitations on who can own stock	Generally freely transferable; can be restricted through buy/sell agreements	Freely transferable by selling the entire business	Generally subject to partners' approval; can be restricted through buy/sell agreements	Generally subject to members' approval; can be restricted through buy/sell agreements
Management	Centralized; board of directors; corporate officers	Centralized; board of directors; corporate officers	Centralized	General partnership: not centralized; Limited partnership: generally centralized	Can be either centralized or not centralized
Liability of owners	Generally limited to assets in corporation	Generally limited to assets in corporation	Unlimited	General partnership: unlimited; Limited partnership: general partner unlimited, limited partner limited to assets in partnership	Limited to assets in the LLC
Contribution of property	Nontaxable only if transaction meets Section 351 requirements	Nontaxable only if transaction meets Section 351 requirements	Nontaxable transaction	Generally a non-taxable transaction; assumption of liabilities by partnership may trigger gain recognition	Generally a nontaxable transaction; assumption of liabilities by LLC may trigger gain recognition
Taxability of income	Generally taxable to shareholder	Taxable to corporation	Taxable to proprietor	Taxable to partner	Taxable to member
Deductibility of losses	Generally deductible by shareholder; liabilities do not increase basis for deducting losses except for direct loans from shareholder	Deductible by corporation	Deductible by proprietor	Generally deductible by partner to extent of basis; liabilities may increase basis for deducting losses	Generally deductible by member to extent of basis; liabilities may increase basis for deducting losses
Special allocation of income/loss	Not permitted	Not applicable	Not applicable	Permitted as long as there is substantial economic effect	Permitted as long as there is substantial economic effect

Attribute	S Corporation	C Corporation	Proprietorship	Partnership	LLC
Passive losses	May not offset active or portfolio income (limits apply at shareholder level)	May offset active income but not portfolio income of closely held corporation; may not offset active or portfolio income of personal service corporation	May not offset active or portfolio income	Cannot offset active or portfolio income (limits apply at partner level)	Cannot offset active or portfolio income (limits apply at member level); generally, members treated as limited partners
Tax year	Generally must use calendar year or make Section 444 election	May select any fiscal year if not a personal service corporation	Must use tax year of proprietor	Generally must use fiscal year of majority interest partners or make Section 444 election	Generally must use fiscal year of majority interest members or make Section 444 election
Qualified retirement plans for employee-owner	Payments are deductible if plan is nondiscriminatory	Payments are deductible if plan is nondiscriminatory	Payments to a Keogh Plan or SEP are deductible	Payments to a Keogh Plan or SEP are deductible	Payments to a Keogh Plan or SEP are deductible
Life insurance for employee-owner	Deductible as compensation	Premiums for first \$50,000 group-term life are deductible and not taxable to employee	Premiums are not deductible	Premiums are not deductible	Premiums are not deductible
Health insurance for employee-owner	Deductible by corporation as compensation; 100% deductible by more-than-2% shareholder	Payments are deductible	100% deductible	Typically deductible by partnership as guaranteed payment; reported as income by partners; 100% deductible by partner	Typically deductible by LLC as guaranteed payment; reported as income by members; 100% deductible by member
Distribution to owner	Nontaxable to shareholder to extent of basis in stock; distribution of appreciated property results in gain recognition by corporation	Not deductible by corporation; generally ordinary income to shareholder; distribution of appreciated property results in gain recognition by corporation	Nontaxable	Nontaxable to extent of basis in partnership; disproportionate distribution of Section 751 assets may trigger gain	Nontaxable to extent of basis in LLC; disproportionate distribution of Section 751 assets may trigger gain
Gain on sale of interest	Capital	Capital; up to 100% of gain from qualified small business stock may be excluded	Capital and/or ordinary depending upon character of assets	Capital (unless <i>hot asset</i> partnership rules apply under IRC Sec. 751)	Capital (unless <i>hot asset</i> partnership rules apply under IRC Sec. 751)
Loss on sale of interest	Ordinary to extent of Section 1244 stock; otherwise, loss is capital	Ordinary to extent of Section 1244 stock; otherwise, loss is capital	Capital and/or ordinary depending upon character of assets	Generally capital	Generally capital
Liquidating distribution	At corporate level treated as sale of property; gain passes through and increases shareholder basis; could trigger built-in gains tax	At corporation level treated as sale of property; gain to shareholder if FMV exceeds stock basis	Nontaxable	Generally, nontaxable; cash distribution in excess of basis will trigger gain; disproportionate distribution of Section 751 assets may trigger gain	Generally, nontaxable; cash distribution in excess of basis will trigger gain; disproportionate distribution of Section 751 assets may trigger gain

Attribute	S Corporation	C Corporation	Proprietorship	Partnership	LLC <sup>a</sup>
Accumulation of earnings	No restrictions	Corporation could be subject to accumulated earnings tax on unreasonable accumulation	No restrictions	No restrictions	No restrictions
Section 179 dollar limitation applied at single level?	No; The dollar limitation applies at the S corporation level and again at the shareholder level	Yes	Yes	No; The dollar limitation applies at the partnership level and again at the partner level	No; The dollar limitation applies at the LLC level and again at the member level
Maximum tax rate	Generally taxed at individual shareholder level	35%, with 3% increase for taxable income between \$15 million and \$18.33 million	35% (effective rate may be higher if exemptions are phased out and itemized deductions are limited)	Taxed at partner level	Taxed at member level
Use of tax credits	Passed through to shareholders to be applied against their tax	Used to offset corporate tax	Used to offset tax of the individual	Passed through to partners to be applied against their tax	Passed through to members to be applied against their tax
Use of NOLs	Passed through to shareholder; limits apply at shareholder level	Used to offset corporate income subject to certain limits	Used to offset individual's income subject to certain limits	Passed through to partner; limits apply at partner level	Passed through to members; limits apply at member level
At-risk rules	Limits apply at shareholder level	Only applicable to certain closely held corporations	Limits apply at proprietor level	Limits apply at partner level	Limits apply at member level
Charitable contributions	Passed through to shareholder; limits apply at shareholder level	Deductible by corporation subject to certain percentage limits	Deductible by individual subject to certain percentage limits	Passed through to partner; limits apply at partner level	Passed through to member; limits apply at member level
Self-employment income to owners	No	No	Yes	Yes, general partners; No, limited partners	Unclear
Cash accounting method	Unrestricted unless inventories are maintained or is a tax shelter <sup>b</sup>	Restricted	Unrestricted	Unrestricted unless inventories are maintained or is a tax shelter <sup>b</sup> or has a C corporation partner	Unrestricted unless inventories are maintained or is a tax shelter <sup>b</sup> or has a C corporation partner
Classes of stock/ownership interests	Restricted	Unrestricted	N/A	Unrestricted	Unrestricted
Number of investors	Limited to 100	Unlimited	N/A	At least two	At least two <sup>c</sup>
Eligible investors	Restricted	Unrestricted	N/A	Unrestricted	Unrestricted

**Notes:**

- <sup>a</sup> Assumes the LLC is a multimember LLC treated as a partnership for tax purposes and not as an association taxable as a corporation.
- <sup>b</sup> If a gross receipts test is met, the cash method may be used even if inventories are maintained.
- <sup>c</sup> Reg. 301.7701-3(b)(1)(ii) disregards a single-member LLC as a separate entity.