

S-Corporation

A. Liability

1. Shareholders granted personal protection from debts and liabilities of business (like c-corp and LLC)

B. Taxation

1. **Pass through:** Profits and losses pass through the corp and reported to the individual tax return of shareholder (same as partnership and LLC)
2. **Self-Employment Tax Break:** Profits of the S-Corp which pass through to the shareholders are not subject to self-employment tax (Social Security and Medicare which is approximately 15%). Rather, self-employment is only taxed on the portion classified as a "reasonable salary". LLCs and sole-proprietorships must pay self-employment tax on all income. The ability to minimize self-employment tax is deemed to be one of the greatest benefits of a s-corporation, but the abuse or misuse of such has been challenged by the IRS and therefore should be reviewed by a CPA as to how such is applicable to your business.
3. **Corporate Losses:** losses in the corporation can be deducted from the individual tax returns of the shareholder thereby allowing them to offset other sources of income such as their W-2 income.
4. **Distribution of Profits and Losses:** No special allocation of profit and losses for shareholders. Corporate profits and losses must be split up proportionately to the percentage of shares owned by each shareholder. LLC's on the other hand allow for flexibility as to how they split their profits and losses.

C. Formalities

1. Must file an S-Corporation annual income tax return each year (IRS Form 1120S)
2. Must file annual report with Secretary of State, and a reporting fee of \$25.
3. Must maintain corporate formalities such as: Drafting Bylaws, Minutes, Annual Meetings, issuance of stock, to keep a paper trail of financial dealings between the corporation and its shareholders, and to avoid "piercing of the corporate veil."

D. Other Characteristics

1. No more than 100 shareholders
2. Shareholders must be US citizens or have US residency status
3. Shareholders must be individuals (not corporations or partnerships)
4. Only one class of stock (but different voting rights permitted, and same rights to participate in dividends and sale of assets)
5. Owners are called "shareholders"

LLC

A. Liability: shareholders granted personal protection from debts and liabilities of business (like s and c-corp)

B. Taxation

1. **Pass through:** Profits and losses pass through the LLC and reported to the individual tax return of shareholder (same as partnership and Corps).
2. **Self-Employment Tax:** LLC members must pay self-employment tax on all income from the LLC.
3. **LLC Losses:** losses in the LLC can be deducted from the individual tax returns of the member thereby allowing them to offset other sources of income such as their W-2 income.
4. **Distribution of Profits and Losses:** It is flexible since an LLC allows you to decide what share of the LLC profits and losses each owner will receive.

C. Formalities

1. Very little formalities required. Operating agreement is recommended, annual meetings not required, but recommended.
2. Must file annual report with Secretary of State, and a reporting fee of \$200.

D. Other Characteristics

1. Owners are called "members"
2. Members may be individuals or separate legal entity such as a corporation.
3. Member's investment receives a percentage ownership interest in return. Percentage ownership determines how profit and losses are split up.