

CHOICE OF ENTITY CHART

		Limited Liability Company (LLC)	S Corporation	C Corporation
1	Limited Liability	All members have limited liability protection.	All shareholders have limited liability protection	All shareholders have limited liability protection.
2	Levels of Federal Income Tax	One	Generally one, but if it's a former C corporation and has too much passive income or built-in gains under Sections 1374 and 1375, certain additional taxes may apply.	Two
3	Number of Owners	Most states require only one member (e.g. MI, DE). Others require at least two.	One to 100 (spouses counted as one) with rules permitting families for up to six generations to be treated as one person.	No restrictions
4	Types of Owner	Any type of owner	Ownership is generally limited to U.S. citizens, residents, and certain U.S. trusts. No corporate or partnership shareholders are permitted, except for certain tax-exempt charitable foundations, ESOPs, certain electing trusts and another S corporation owing 100% of the stock where the subsidiary S corporation has made the QSub election.	Any type of owner
5	Classes of Ownership	Multiple classes are permitted	Only one class of stock is permitted. There can be differences in voting rights, however, and debt may be used.	Multiple classes are permitted.

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6	Restriction on Ownership of Subsidiaries	No restrictions	No restrictions on ownership of C corporation subsidiaries. An S corporation may also have a wholly owned S corporation subsidiary ("QSub") or own interests in an LLC or other partnership.	No restrictions
7	Tax Year	Generally calendar	Generally calendar	No restrictions
8	Use of Cash Method of Accounting (Section 448)	Somewhat unclear; an LLC probably cannot use the cash method if it has a C corporation member or if more than 35% of the LLC losses are allocable to non-manager members; exceptions may be available for farming, personal services, and entities with less than \$5,000,000 in gross receipts.	Generally permissible	Generally not permissible unless the corporation is a personal service corporation, a farming business, or has less than \$5,000,000 in gross receipts.
9	Taxation of Contributions of Property to Entity	Nontaxable unless disguised sale, the member is relieved from debt, or the LLC would be treated as an investment company if incorporated. (I.R.C. § 721).	Taxable, unless the transferor meets the 80% control test of I.R.C. § 351, in which case the transfer is nontaxable except to the extent of debt relief.	Same as for S corporations.
10	Special Allocations of Taxable Income and Loss	Yes, provided allocations have "substantial economic effect".	No	N/A
11	Deductibility of Losses (and basis for entity-level debt)	A member may deduct allocable share of LLC's losses only to the extent of the member's basis in the LLC which includes the member's allocable share of LLC debt (I.R.C. § 704).	A shareholder may deduct allocable share of corporation's losses only to the extent of the shareholder's tax basis in his/her shares, which does <u>not</u> include any portion of the corporation's debt.	Shareholders may not deduct any of the corporation's losses (unless shareholder is another corporation filing a consolidated return).
12	Taxation of Cash Distributions	Nontaxable to the extent of a member's tax basis in LLC interest (I.R.C. § 731).	Generally nontaxable to the extent of the shareholder's tax basis in stock (I.R.C. § 1368).	Taxable as dividends to the extent of the corporation's earnings and profits, then nontaxable to the extent of the shareholder's tax basis in his/her shares; then taxable as capital gain to the extent it exceeds basis.
13	Taxation of Distributions of Appreciated Property	Nontaxable to the extent of a member's tax basis in LLC. Exceptions exist for marketable securities and non-contributed property (I.R.C. § 731).	Generally nontaxable at corporate level but taxable at shareholder level through pass-through of corporate tax items of gain triggered on distribution (I.R.C. § 1368).	Generally taxable to both corporation and shareholders. (I.R.C. § 331 (effect on shareholders); I.R.C. § 336 (effect on corporations)).

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14	Taxation Upon Liquidation	Nontaxable to the extent of a member's basis in LLC. Exceptions exist for marketable securities and non-contributed property (I.R.C. § 731).	Generally nontaxable at corporate level but taxable at shareholder level through pass-through of corporate tax items (I.R.C. § 1368).	Generally taxable to both corporation and shareholders. (I.R.C. § 331 (effect on shareholders); I.R.C. § 336 (effect on corporations)).
15	Section 1244 Stock; ordinary loss on the sale or liquidation of ownership interest	No	Yes, individual shareholders who are original investors may qualify for ordinary loss treatment under Section 1244 in an amount up to \$100,000 per year per couple.	Same as for S corporations.
16	Section 1202 Stock; 50% exclusion for gain from sale of qualified small business stock	No	No, Section 1202 applies only to "qualified small businesses," which extends only to C corporations (I.R.C. § 1202).	Yes, individual shareholders who are original investors when the corporation meets the requirements of Section 1202 may qualify for 50% exclusion of gain on sale of stock.
17	Section 754 Election to Adjust Inside Basis of Owner and Entity Upon Sale of an Owner's Interest or Distribution of Property	Yes	No	No
18	Self-Employment Tax on Distributive Share of Income	Not clear, but generally yes as to active members and any manager; no as to non-active members or as to returns on invested capital (i.e., rental income).	No	N/A
19	Reasonable Compensation Issue	No	No, but might be challenged if compensation set unreasonably low to avoid employment taxes.	Yes
20	Health Insurance Deduction	100% (I.R.C. § 162(1)).	100% (I.R.C. §§ 162(1), 1372(a)).	Fully deductible if company reimburses taxpayer or their dependents for medical care expenses, even if discriminatory; not income to shareholder (I.R.C. §§ 105 (a), 106).
21	Group Term Life Insurance	Premiums not deductible; paid with after-tax funds (I.R.C. § 264(a)).	If more than 2% shareholder, same as for LLCs.	Premiums deductible; exclude from shareholder's income the cost of \$50,000 worth of coverage (I.R.C. § 79(a)).

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22	Disability Insurance (both group and personal)	No deduction; paid with after-tax funds; proceeds not taxable (I.R.C. § 105(g); Rev. Rul. 58-90, 1958-1 C.B. 88).	If more than 2% shareholder, same as LLCs.	Premiums deductible; not income to shareholder, but if premiums paid by corporation, proceeds are taxable to shareholder (I.R.C. §§ 105(a), 106).
23	Payment of Uninsured Medical Expenses	Payments generally not deductible; paid with after-tax funds (I.R.C. § 105(g)).	If more than 2% shareholder, same as LLCs.	If nondiscriminatory, deductible and excludable by shareholder. Annual physicals may be provided on discriminatory basis. (I.R.C. § 105(h); Reg. § 1.105-11(g)).