To C or Not to C? Entity Selection in the New Tax Age

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Topics

Choice of Entity – What is the Context?

- Are you choosing an entity or structure for a **new business**, yet to be formed?
- Are you considering whether an **existing business** is operating in the optimal structure for tax purposes or whether it should change its structure to improve its tax result (by, for example, becoming a C corporation)?
- In the former case, your decision is dependent upon the client's projections and expectations ("we'll be IPOing next year!!") but in the latter case you have previous results of the business to guide you.

Choice of Entity: the Menu (Read Through Tax-Colored Glasses)

- Pass-through entities:
  - Sole proprietorships
  - S Corporations
  - Partnerships (LPs, GPs, LLPs, PTPs, LLCs)
- Corporate entities
  - C corporations
  - C corporations that qualify under section 1202

Tax Considerations in Entity Choice

What tax factors should be considered?

- Tax Rate/ Effective Tax Rate, but also:
  - Two-tier taxation vs. one-tier taxation
  - Profile of owners (single owner, foreign, tax-exempt, closely-held)
  - State tax profile (deductibility, filing issues)
  - Loss pass-through important?
  - Fiscal year important?
  - Cash method important?
  - Partnership special allocations important?
  - Even if tax rates are your sole criterion, remember that rates can change (but a C corp is forever…)

Tax Rates After Tax Reform

- C Corporation:
  - 21% rate
  - No longer graduated
  - Alternative minimum tax repealed (AMT)
  - No capital gains rate
  - Effective rate on earnings distributed to shareholders is 36.8% (21% plus 20% on qualified dividend income of $79)
  - If earnings are not distributed, 21% rate becomes effective rate, but beware accumulated earnings tax and personal holding company tax could apply to corporation.

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