

Rock, Paper, Scissors? Choice of Entity After Tax Reform

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Topics

- I. Choosing Ab Initio vs. Changing Midstream**
- II. Defining the Universe of Entities**
 - A. Corporate Entities (C and §1202)**
 - B. Tax Pass-through Entities**
- III. Tax Considerations in Entity Choice**
 - A. Tax Rates/Effective Rates**
 - 1. C Corporations
 - 2. §1202 Corporation
 - 3. Pass-Throughs and §199A
 - 4. Carried Interests
 - B. Beyond Rates: Other Tax Considerations**
- IV. Overriding Non-Tax Considerations**
- V. Those Who Have Switched to C and Why**
- VI. Practice Problems**
- VII. Appendix – Rate Calculations**

Choice of Entity – What is the Context?

- **New Business.**
- **Existing Business:** Restructure or convert? Is the current structure the optimal structure for tax purposes or should it change its structure to improve its tax result (by, for example, becoming a C corporation)?
- Dependent Upon Client Projections (“we’ll be IPOing next year!!”).
- Model results of structure
- No one-size fits all

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

- Sole Proprietorship.
- Pass-through entities (“RPEs” in §1.199A-1(b)(9)).
 - S corporations.
 - Partnerships (LPs, GPs, LLPs, PTPs, LLCs).
 - Disregarded entities (“DREs”).
- Corporate entities.
 - C corporations.
 - C corporations that qualify under section 1202.
- Others.
 - PTPs.
 - REITs.
 - Cooperatives.

Tax Rates After Tax Reform

- C Corporation:
 - 21% rate.
 - No longer graduated.
 - Corporate alternative minimum tax repealed (AMT).
 - No favorable 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 of numerous anti-abuse regimes.

Tax Rates After Tax Reform – Anti-Abuse

- C Corporation:
- **Caution:** C corporations are subject to numerous anti-abuse regimes:
 - Personal holding company (IRC § 541).
 - Accumulated earnings tax (IRC § 531).
 - Personal service corporation (IRC §§ 170, 267, 269A, 280H, 441, 448).
 - Closely held corporation (or closely held C corporation) (IRC §§ 170, 465, 469).
 - But IRC § 341 (collapsible corporation recharacterized as sale of ordinary income assets) is still dead.

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