# “S” Corporation versus LLC

### How are they different and how are they the same?

Why is an LLC a better vehicle in which to hold title to real property and why do more people choose “S” Corporations to form operating entities? Both types of entity offer pass through tax treatment, meaning income and losses pass through to the shareholders/members and there is no tax due at the entity level. For income tax purposes, an “S” Corporation is treated like a sole proprietorship if there is one owner, or like a partnership if there are two or more owners. Single member LLCs are treated as disregarded entities and those with two or more members, like partnerships (unless they elect otherwise). In pass through entities, the owner’s share of business income, credits, deductions, losses, and all the tax items pass through and are reported on their personal tax return.

However, there are differences. There are strict requirements to qualify for an “S” Corporation election, including:

A. Profits and losses distributed to share holders must match the equity interest in the corporation,

B. There may be only one class of stock,

C. They may be no more than 100 hundred shareholders,

D. All shareholders must be U.S. citizens or green card holders (with certain limited types of trusts and exempt organizations allowed).

To the contrary, there are no such restrictions on who may be a member of an LLC and many different types of equity interests are allowed, such as holding of the shares by other LLC’s, trusts, etc. In addition, percentage of profits and losses do not have to be tied directly to percentage of ownership. For estate planning purposes, LLC’s are generally far superior in flexibility to Corporations.

On the other hand, one of the advantages of using an “S” Corporation is with respect to excess profits. Unlike with an “S” Corporation, (as of 2013) with an LLC, up to the first $113,700.00 of profits distributed to members may be subject to a self employment tax of 15.3%.

However, the distribution of appreciated property from an "S" Corporation will be treated as a recognition of gain proportionate to the shareholder's ownership percentages in the Corporation, with basis in the property being received treated as equal to the fair market value of the property received at the time of distribution. Generally speaking, LLC's can make tax free distributions of appreciated assets to its members (provided the members' adjusted basis in the LLC exceeds their capital account balance). Transfers of property in and out of an LLC are free of immediate tax consequences with a member receiving a carryover basis in the distributed assets, not to exceed their basis in the LLC. In light of this, a conversion from an "S" Corporation to an LLC will create tax issues, but a conversion from an LLC to an "S" Corporation will not. The distribution by an LLC will be tax deferred.

A significant difference between "S" Corporations and LLCs is that in an "S" Corporation, shareholders only get basis in their shares for their personal loans made to the corporation, but not for any other third party entity level debt, even if they personally guaranty the debt. On the other hand, in an LLC, member level tax basis increases are permitted for all liabilities, whether recourse or non-recourse, even when obtained from third parties. Therefore, the LLC is generally preferable where the entity will own real property subject to debt.

Further, LLC members often enjoy cash flow credit in their taxable income and may claim tax losses and receive distributions in excess of capital contributed, without a current tax cost (provided that the negative amount does not exceed the member's adjusted basis in the LLC).

This article is not intended to be tax advice and there are many caveats and variations on the rules expressed here. You are advised to consult with your accountant or tax attorney for advice in connection with your particular situation. However, given the number of times I have been asked by my clients to explain the difference between the two forms of entity, this article is intended to differentiate the two entities in certain circumstances. While this is not an exhaustive list of the similarities and differences between the two entities, these are some examples of similarities and differences which I have encountered.

**Robert Bichoupan is the founder of Robert Bichoupan, P.C. and has been in practice 22 years, primarily in the areas of estate planning and real estate. Further information on these subjects may be found at www.Bichoupan.com.**