



TAX ADVISOR

June 2008

AND THE WINNER MIGHT BE...LIMITED LIABILITY COMPANY!

When a client comes to your office and requests assistance in forming a new venture, you have many options to discuss. Options for the new venture can include: a C corporation; an S corporation; a limited liability company (LLC); a limited partnership; tenancy in common; or a general partnership.

Each option has its own pros and cons. Therefore, each option has different tax consequences. Since LLCs enjoy many of the benefits of other forms of business with fewer detriments, many Advisors defer to the LLC form of business, taxed as a partnership. An LLC may choose to be taxed either as a corporation or as a partnership. However, there remain significant circumstances for S Corporations or Joint tenancies with limited liability to still prevail over LLCs.

For the Advisor, the key to successfully traversing this area is not found in the sample agreements. The successful formation and operation of an entity lies in the details of formation and operation, and in knowing the correct questions to ask.

- 1. What assets and liabilities will be contributed, if any, at the formation of the partnership?** For example, where Investor A contributes highly appreciated depreciable assets and Investor B contributes cash, partnership law requires that all of the pre-contribution gain be allocated to Investor A as 704c gain. However, an S Corporation would not require such an allocation of gain to Investor A. This is particularly important when Investor A will be bought out in less than 7 years from the venture. Further, the member contributing property to an LLC would find that he or she may receive a lesser share of depreciation deductions, to offset the contribution of cash by Investor B. This is not so with an S Corporation.
- 2. What is the tax impact on a subsequent contribution to the entity?** For example, subsequent contributions by members can cause the holding period for that portion of the LLC to restart and cause short term capital gain on its subsequent sale. This action can also trigger a deemed distribution of cash upon release of debt by the entry of a new member. Subsequent contributions to an S Corporation may not be tax deferred.
- 3. How does the type of entity affect Compensation, Profits and Self-Employment Taxes?** An S corporation shareholder's distributive share of income or loss is not subject to self-employment tax, unlike an LLC member's distributive share, depending on the member's role in the LLC. Guaranteed payments that represent compensation for services and the distributive share of profits and losses of an LLC member (who meets the definition of a general partner, e.g. managing members) are subject to self-employment tax. Members that are the equivalent of a limited partner, e.g. non-managing member, only include the guaranteed payments for services in the self-employment tax computation.
- 4. What is the difference in tax impact on Purchase of Ownership Interest of a Withdrawing Owner?** For an entity that owns depreciable assets, the choice of S Corporation versus LLC will be significant in a number of areas, especially the tax impact on the purchase of the ownership interest of a withdrawing Owner. The LLC member will receive as income his or her proportionate depreciation recapture on a purchase by another owner. An S Corporation shareholder will generally be taxed at capital gain rates.
- 5. What are the Differences in Profit Allocation for LLCs and S Corporations?** LLCs can allocate profit and losses to take advantage of its members' different objectives and tax rates. S corporations can not.

How can Advisors in Accounting Firms and Law Firms ensure that all angles of forming an entity are being considered for the best tax consequences for the owners? Consider partnering your firm with **Robison Law Firm**. Stephen L. Robison is a full-time, practicing tax attorney who is a Board Certified Federal Tax Specialist since 2002. Mr. Robison, and our team of tax professionals at **Robison Law Firm**, will work with you and your clients to consider all of the venture options for the best tax consequences for the owners.



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