

Summary - Tax Advantages & Disadvantages

	Advantages	Disadvantages	Property/Services
Sole Proprietorship	<p>All profits and losses passed through.</p> <ul style="list-style-type: none"> - No double taxation. - Can use losses immediately, although there may be passive activity loss limits. - No Aat-risk@ limits on losses. 	<ul style="list-style-type: none"> - Difficult to re-invest profits, since must pay tax on profits in year earned. 	<p><u>Property</u>: No taxable event for contribution of property.</p> <p><u>Services</u>: Compensation received for services is taxed as income.</p> <p><u>Disposition</u>: Sale of real & personal property is capital gains if investment or business property.</p>
General Partnerships	<p>All profits and losses passed through.</p> <ul style="list-style-type: none"> - No double taxation. - Can use losses immediately, although there may be passive activity loss limits. - No Aat-risk@ limits on deductions. Partners can write off losses in excess of investment since GP=s are fully liable for all debts of partnership. 	<ul style="list-style-type: none"> - Taxed on distributive share of profits. Difficult to re-invest profits, since must pay tax on profits in year earned. Must distribute enough cash to pay taxes on distributive share of income. 	<p><u>Property</u>: No taxable event for contribution of property. Partnership retains contributing partner=s basis.</p> <p><u>Services</u>: Interests granted for services are taxed as income. However, need not provide consideration for interest in partnership.</p> <p><u>Disposition of Each Partners Interest</u>: Capital gains to that partner (sales price less basis)</p> <p><u>Distribution of Partnership Assets</u>: Pass through capital gains/loss. Note low basis of contributing partner.</p>
Limited Partnership	<p>All profits and losses passed through.</p> <ul style="list-style-type: none"> - No double taxation. - Can use losses immediately, although there will likely be passive activity loss limits for limited partners (but not GP=s). - Losses limited to basis Aat-risk@. However, real estate, non recourse debt can increase basis for purposes of loss deductions. 	<ul style="list-style-type: none"> - Taxed on distributive share of profits. Difficult to re-invest profits, since must pay tax on profits in year earned. - Default is Subchapter K partnership taxation under the Acheck box@ rules but can elect C corporation taxation. 	<p><u>Property</u>: No taxable event for contribution of property. Partnership retains contributing partner=s basis.</p> <p><u>Services</u>: Interests granted for services are taxed as income.</p> <p><u>Disposition of Each Partners Interest</u>: Capital gains to that partner (sales price less adjusted basis)</p> <p><u>Distribution of Partnership Assets</u>: Pass through capital gains/loss. Note low basis of contributing partner.</p>
Limited Liability Companies	<p>All profits and losses passed through.</p> <ul style="list-style-type: none"> - No double taxation. - Can use losses immediately, although there will likely be passive activity loss limits for anyone not materially participating. - Losses limited to basis Aat-risk@. However, real estate, non recourse debt can increase basis for 	<ul style="list-style-type: none"> - Danger of being taxed as a corporation is devastating! Must elect partnership taxation under Acheck box@ rules. 	<p><u>Property</u>: No taxable event for contribution of property. Partnership retains contributing partner=s basis.</p> <p><u>Services</u>: Interests granted for services are taxed as income.</p> <p><u>Disposition of Each Partners Interest</u>: Capital gains to that partner (sales price less basis)</p> <p><u>Distribution of Partnership Assets</u>: Pass through capital gains/loss. Note low basis of contributing partner!</p>

	purposes of loss deductions.		
Corporations	<ul style="list-style-type: none"> - Some minor tax-bracket advantages in some limited income ranges above \$650k. - Can reinvest income in business without <i>investors</i> facing tax liability for income. Don't have to distribute income to stockholders. 	<ul style="list-style-type: none"> - Double taxation of dividend and liquidating distributions (although can escape through other distributions) - Taxation of excessive salary, debt as constructive dividends. - Penalties for accumulated earnings in larger corps. 	<p><u>Contribution of Property</u>: Capital gain event - contributor must pay taxes. However, stepped up basis for the corporation. Can avoid capital gains by qualifying for tax-free exchange.</p> <p><u>Contribution of Services for Shares</u>: Taxable income.</p> <p><u>Disposition of <i>shares</i></u>: Capital gains/losses to the shareholder.</p> <p><u>Disposition of Corp. Assets</u>: Double taxation!!!</p>
S Corporations	<ul style="list-style-type: none"> - Treated like a partnership: conduit for profits and losses. Profits and losses passed through. - No double taxation. - Can use losses immediately, although there may be passive activity loss limits and at-risk loss limits. 	<ul style="list-style-type: none"> - Taxed on distributive share of profits. Difficult to re-invest profits, since must pay tax on profits in year earned. - Default is Subchapter K partnership taxation under the Acheck box@ rules but can elect C corporation taxation. 	Same as AC@ corporations.

1. All taxpayers are limited by passive activity loss limits. Unless the taxpayer Amaterially participates@ in the business, the losses are passive activity losses and can be deducted in that tax year only against passive activity income from other investments. The losses can be carried forward to future tax years and applied against passive activity income in those years or upon complete disposition of the property. AMaterial participation@ requires **personal involvement in the management or operation on a regular, continuous and substantial basis throughout the year.**

2. Reasonable payments to shareholders for: (i) property leased by shareholders, or (ii) services performed by shareholders, or (iii) interest on loans from shareholders B is deductible by the corporation. Thus, the corporation avoids taxation on income at the corporate level to the extent of these payments to shareholders.. However, unreasonable distributions that are hidden attempts to avoid taxation at the corporate level will be taxed as Aconstructive dividends.@