

Limited liability company as choice of entity

A limited liability company (LLC) is somewhat of a hybrid entity in that it can be structured to resemble a corporation for owner liability purposes and a partnership for federal tax purposes. This duality can provide the owners with the best of both worlds.

Like the shareholders of a corporation, the owners of an LLC (called “members” rather than shareholders or partners) are generally not liable for the debts of the business except to the extent of their investment. Thus, the owners can operate the business with the security of knowing that their personal assets are protected from the entity's creditors. This protection is far greater than that afforded by partnerships. In a partnership, the general partners are personally liable for the debts of the business. Even limited partners, if they actively participate in managing the business, can have personal liability.

Unlike a regular or “C” corporation, an LLC can be structured to be treated as a partnership for federal tax purposes. This can provide a number of important benefits to the owners. For example, partnership earnings are not subject to an entity-level tax; instead, they “flow-through” to the owners, in proportion to the owners' respective interests in profits, and are reported on the owners' individual returns. Thus, earnings are taxed only once. In addition, since you are actively managing the business, you can deduct on your individual tax return your ratable shares of any losses the business generates. This, in effect, allows you to shelter other income that you and your spouse may have.

An LLC that is taxable as a partnership can provide special allocations of tax benefits to specific partners. This can be an important reason for using an LLC over an S corporation (a form of business that provides tax treatment that is similar to a partnership). Another reason for using an LLC over an S corporation is that LLCs are not subject to the restrictions the Internal Revenue Code imposes on S corporations regarding the number of owners and the types of ownership interests that may be issued.

In summary, an LLC would give you corporate-like protection from creditors while providing you with the benefits of taxation as a partnership. For this reason, you should seriously consider operating your business as an LLC. Please contact us to discuss in more detail how use of an LLC might benefit you and the other owners.