

Entity Comparison Chart

	Sole Proprietorship—Tab 6**	Partnership—Tab B	C Corporation—Tab C	S Corporation—Tab D	Limited Liability Company—Tab F
IRS Pub.	334	541	542	None***	541
IRS Form	Schedule C, Form 1040	Form 1065	Form 1120	Form 1120S	Form 1065****
Entity Description	A sole proprietorship consists of one individual who carries on an unincorporated trade or business. (If a husband and wife carry on a business together as partners, they should file Form 1065, U.S. Return of Partnership Income.) <i>Exception:</i> Husband and wife residing in a community property state may treat the business as a sole proprietorship.	A partnership is an organization having two or more owners that functions as a trade or business. A joint undertaking merely to share expenses or ownership of property does not necessarily constitute a partnership. An LLC with two or more members is generally classified as a partnership for tax purposes. A partnership can elect to be taxed as a corporation.	A corporation is a business entity that carries its own legal status, separate and distinct from its owners. A corporation cannot elect out of corporate taxation. See <i>Check the Box Rules</i> on Page F-1.	A corporation can elect to be taxed as an S corporation by filing Form 2553. Only domestic corporations with one class of stock are eligible. An S corporation is limited to 100 shareholders, and may not have another corporation as a shareholder. (An exception exists for qualified subchapter S subsidiaries.) Other restrictions apply.	An LLC is a liability-limiting entity formed under state law. It is treated as a disregarded entity, partnership or corporation for federal income tax. For purposes of this chart, the LLC is assumed to be a multi-member LLC taxed as a partnership. Single-member LLCs are usually treated as disregarded entities taxed directly to their owner. See the <i>LLC Entity Classification</i> discussion beginning on Page F-1.
Taxation	Net profit or loss is computed on Schedule C and is reported as income or loss on the owner's Form 1040.	Partnership income and expenses flow through to the partners. Income is taxed to the partner whether or not distributed. Pass-through items retain the same character in the partner as they had in the partnership.	A C corporation pays tax on its profits. When shareholders take profits from the corporation, the distributions are usually taxable dividends (double taxation). Personal service corporations are taxed at a high, flat rate.	An S corporation is taxed similar to a partnership. Income and expenses flow through to shareholders. Pass-through items retain the character in the hands of the shareholder they had in the corporation.	Same as a Partnership in this chart.
Wages and SE Tax	The owner is subject to SE tax of 15.3% of net earnings from self-employment. SE tax is computed on Schedule SE and is reported as "Other Taxes" on Form 1040. Deduct one-half of SE tax as an adjustment to income on line 27 of Form 1040.	A general partner's share of business income (including guaranteed payments) is subject to SE tax. A limited partner's share of business income is not subject to SE tax unless the partner performs services for the partnership. Other items, such as interest and dividends, retain their character and are passed through to the partner's individual income tax return.	Shareholders who perform services for a corporation, including officers, are treated as employees. Wages of corporate employees are subject to payroll tax and withholding. Wages paid to employee-shareholders must be reasonable. Dividend distributions are not subject to SE tax.	An employee-shareholder of an S corporation receives wages for services rendered. These wages must be reasonable. Additional profits are passed through to the shareholder and are taxable for income tax purposes but not for SE tax purposes. Double taxation of profits is avoided.	Profits are subject to income tax in the same way as a partnership. Members' business income (including guaranteed payments) may be subject to SE tax. See <i>Difference Between LLC Members and Limited Partners in a Partnership</i> on Page F-3 for exceptions.
Losses	Business losses can offset other income such as interest, capital gains or a spouse's wages if filing a joint return. Subject to hobby, passive activity and at risk loss rules under Sections 183, 469 and 465, respectively.	Losses flow through to partners. Recognition of loss by a partner is limited by the partner's basis, at-risk rules and passive activity rules. Subject to "hobby loss" rules under Section 183.	Capital losses are allowed only to the extent of capital gains. Net operating loss of a corporation is carried back or forward against corporate income, but is not passed through to shareholders.	Losses flow through to shareholders. Recognition of loss is limited by the shareholder's basis, at-risk rules and passive activity rules. Subject to "hobby loss" rules under Section 183.	Losses flow through to members. Recognition of loss by members is limited by the member's basis, at-risk rules and passive activity rules. Subject to "hobby loss" rules under Section 183.
Fringe Benefits (See Tab K)	Amounts paid on behalf of employees are deductible; those paid on behalf of proprietor are not. <i>Exception:</i> Proprietor can deduct medical insurance premiums and reimbursement costs under an accident and health plan that covers all employees. If proprietor's spouse is covered under a plan that also covers owner as part of family, deduction is allowed.	Generally included in partner's income as a guaranteed payment. <i>Exception:</i> Nontaxable benefits include, among others, legal service plans, educational and dependent care programs and certain working condition and <i>de minimis</i> fringe benefits and employee achievement awards.	Owner-employees are entitled to the same tax-free fringe benefits as other employees (subject to discrimination rules).	Generally included in income for employee-shareholders owning more than 2% of stock. <i>Exceptions:</i> Contributions to retirement plans; compensation for injury or sickness; educational and dependent care programs; employee discounts; working condition and <i>de minimis</i> fringes and no-additional-cost services.	Same as a Partnership in this chart.
Personal Liability	The sole proprietor is liable for all business debts and actions.	General partner personally liable for all partnership debt. Limited partner's liability usually limited to investment in partnership.	Shareholders not liable for debts incurred by corporation. Liability generally limited to amount invested.*	Shareholders not liable for debts incurred by corporation. Liability generally limited to amount invested.*	The degree of liability protection for LLC members varies from state to state.

* **Caution:** The courts may disregard the so-called "corporate liability shield" in the case of single shareholder corporations.

** In the *1040 Quickfinder® Handbook*.

*** IRS Pub. 589 regarding S corporations was last issued in 1995.

**** A disregarded single-member LLC is included on the tax form of its owner (1040, 1120, etc.).

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Organization and Administration	A sole proprietorship is the easiest business to organize. Intermingling of business and personal funds is allowed (although not recommended). Business income is reported on Schedule C, which is filed with the owner's Form 1040.	A partnership is easy to organize. A written partnership agreement is recommended, but not required. The agreement determines how income and losses are allocated to the partners. If a partnership agreement does not exist, partnership items pass through based on partners' ownership interests.	A corporation is difficult and expensive to organize. Corporations must hold periodic board meetings and keep minutes. Corporations must comply with federal and state regulations.	An S corporation is set up as a regular corporation. S corporations must make election to be treated as an S corporation by filing Form 2553. Certain events will cause automatic termination of S status. See <i>Terminations</i> on Page D-3.	An existing partnership can generally register for LLC status in the state in which it conducts business. Registration is generally less complicated than forming a corporation.
Bookkeeping and Accounting	There are fewer requirements on what type of bookkeeping system or accounting method is used in sole proprietorships. The system must be consistent, clearly reflect income and expenses, and allow the taxpayer to file an accurate return. The sole proprietorship must use the same tax year as the owner.	Depending on income and assets, the partnership may be required to include a balance sheet with its income tax return. Therefore, the partnership should use the double-entry bookkeeping method. If a partner exchanges property other than cash in exchange for an interest in a partnership, special accounting rules apply. See <i>Contributed Property</i> on Page B-6.	The balance sheet on a corporation's income tax return must agree with the corporate books. A corporation must use a double-entry bookkeeping system. It must file all necessary employment and income tax returns.	The balance sheet on an S corporation's income tax return must agree with the corporate books. An S corporation must use double-entry bookkeeping. An S corporation must file all required payroll and income tax returns.	Same as a partnership.
Owner Control and Flexibility	The owner is free to make all business decisions.	Control of the business operations is divided among partners.	Shareholders have control over the corporation to the extent they own voting stock.	Shareholders have control over the corporation to the extent they own voting stock.	Control is divided among members.
Transfer of Ownership	A sole proprietorship is not a separate entity from its owner. "Sale" of a sole proprietorship is actually a sale of assets.	The partnership agreement may restrict the sale of a partnership interest, and may control the terms of the sale.	Ownership is easily transferred by selling shares of stock. The corporate charter may place certain restrictions on the sale of stock.	Ownership is easily transferred by selling shares of stock to eligible shareholders. The corporate charter may place certain restrictions on the sale of stock.	The operating agreement may restrict transfer of ownership interests.
Advantages and Disadvantages	<p>Advantages:</p> <ul style="list-style-type: none"> – Minimum legal restrictions. – Easy to discontinue. <p>Disadvantages:</p> <ul style="list-style-type: none"> – Unlimited liability. – May not bring in new owners or outside capital contributions. – Income tax cannot be deferred by retaining profits. 	<p>Advantages:</p> <ul style="list-style-type: none"> – A partnership combines the skills and/or financial abilities of several people. – Easy to establish. – Business usually benefits from partners who have complementary skills. <p>Disadvantages:</p> <ul style="list-style-type: none"> – A partnership is often easier to get into than out of. – General partners are liable for actions of other partners—unlimited liability. – Sharing of profits. – Disagreements in decision making. 	<p>Advantages:</p> <ul style="list-style-type: none"> – Limited liability. – Perpetual life. – Ability to raise capital through issuance of stock. – Ease of transfer of ownership. <p>Disadvantages:</p> <ul style="list-style-type: none"> – Double taxation of profits. – Corporate charter restricts types of business activities. – Subject to various state and federal controls. 	<p>Advantages:</p> <ul style="list-style-type: none"> – Limited liability and perpetual life. – Avoids double taxation of profits. – Profits passed through are not subject to SE tax as in a partnership. – Ability to raise capital through issuance of stock. <p>Disadvantages:</p> <ul style="list-style-type: none"> – Shareholders pay tax on earnings even if undistributed. – Less flexibility in choosing a tax year. – Contribution limits to a qualified retirement plan are based on employee-shareholder's wages, not overall profits such as a sole proprietor or partner. 	<p>Advantages:</p> <ul style="list-style-type: none"> – Avoids certain S corporation restrictions. – Avoids double taxation of profits. – Business usually benefits from members who have complementary skills. <p>Disadvantages:</p> <ul style="list-style-type: none"> – Inconsistent treatment state to state. – Must have at least two owners to be taxed as a partnership for federal tax purposes. – Sharing of profits. – Disagreements in decision making.

Business insurance. The limited liability characteristics of certain business entities should not be considered a substitute for proper insurance coverage. The business owner should consider coverage to protect against fire and theft, business interruption, errors and omissions, employment practices, employee benefit plans and employee dishonesty. General liability coverage, including umbrella policies for personal injury and property damage, should also be considered. See *Workers' Compensation* on Page M-10.

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