

Overview of Corporations versus LLC's

The LLC has also eclipsed the corporation as the preferred business entity in most circumstances. Though the corporate structure remains useful for larger companies, it has drawbacks over the LLC for the smaller venture.

·**Statutory inflexibility.** Corporate laws are comprehensive and less flexible than LLC laws. Corporate by-laws rigidly define how a corporation will operate. In contrast, LLC operating agreements may allow LLC members to structure their company to best suit their specific needs. Corporate laws favor large companies. Small and medium companies may find the corporate statutory inflexibility a hindrance to shaping their enterprise.

·**More cumbersome operational requirements.** Corporate decision-making must adhere to complex procedural formalities that are often too cumbersome for small and medium-sized businesses. Certain corporate decisions require stockholder votes. Important decisions must be through formal corporate board meetings. Failure to observe these formalities may allow creditors to pierce the corporate veil and directors and/or shareholders can then be personally responsible for company debts. LLC managers have broad leeway to make decisions without formality – except in those few instances defined in the LLC's operating agreement. LLCs may also be structured to give the members as little or as much control over operational decisions as is desired.

·**Limited Choice of Tax Classification.** A corporation may choose to be taxed only one of two ways: The Internal Revenue Code refers to them as C corporations and S corporations. The C corporation may be undesirable because the corporation pays a tax on its profits and its stockholders are taxed when they receive a distribution of profit (a stock dividend). To avoid this double taxation, most small corporations elect to be taxed as S corporations, where only the owners are taxed on corporate profits (pass-through taxation). However, a corporation must meet strict criterion to qualify for S corporate tax status and such requirements often constrict the operation or financing of the business. An LLC, however, may be taxed as a C corporation, S corporation or partnership if owned by multiple taxpayers or as a disregarded entity if owned by only one taxpayer. Partnership taxation is often seen as preferable to S or C corporate tax status, because it avoids a C corporation's double taxation and the structural limitations required of S corporations. Furthermore, unlike corporations, a return of capital from the LLC to a partner/LLC member usually doesn't trigger a tax and a distribution of profit need not be proportional to one's ownership interest in the company. Nonetheless, if an LLC chooses to be taxed as either a C or S corporation it may do so, while corporations, in turn, may not choose to be taxed as a partnership or disregarded entity.

Despite the drawbacks of corporations, there are instances where a corporation is preferred over an LLC. The main benefit of corporations is its stock may be freely transferred without the consent of other shareholders or corporate management. This is essential for any publicly traded company. Companies that plan a public offering should be a corporation. Furthermore, any company that wants easy transferability of ownership or that has a complex equity structure should prefer the corporate form of organizations. Finally, some businesses – such as banks, insurance companies or public utilities – are required by law to be corporations. Most other

companies, however, would find it advantageous to be formed as an LLC, a limited partnership (LP) or limited liability partnership (LLP).

An LLC is similar to an S corporation since the owners of both entities enjoy limited liability and both entities can be taxed as a proprietorship or partnership and thus enjoy the benefits of pass-through taxation. An LLC member's risk, as with a corporation, is also limited to loss of investment. However, a chief asset protection advantage of the LLC over the S corporation is that the LLC affords you more protective ownership options. For example, an LLC can be owned by a family limited partnership (FLP), a trust, another corporation, and so forth. S corporation shares cannot be owned by these entities. Their stock ownership is primarily restricted to individuals. Both estate and asset protection planning become more difficult with S corporation shares.

More importantly, an ownership interest in an LLC has considerably greater creditor-protection than shares in an S corporation which can be easily seized by a stockholder's personal creditors. A member's interest in an LLC is creditor protected in the same way a partner's interest in a limited partnership is protected. A member's personal creditor is limited only to a charging order against the LLC interest. This gives the creditor only the right to receive distributed profits due the debtor partners.

Finally, because an LLC can choose to be taxed as an S corporation, it can be argued that the S corporation will become obsolete as a business entity. Corporations may only be suitable for companies that plan to go public or have large, complex equity structures. Because an S corporation's ownership is limited to 100 shareholders, it cannot go public. This will limit it to a simple equity structure. Only in rare circumstance would one form an S corporation instead of an LLC.

There are still several advantages of an S corporation over the LLC: 1) An S corporation can be more tax advantageously acquired by another business, 2) S corporation owners pay employment taxes only on their salaries; LLC owners pay employment taxes on all profits and 3) state taxes are sometimes lower for an S corporation.