

Choosing an Entity for Your New Business

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Wisconsin Entity Forms

Entity Type	Statutory Provisions
Business Corporations <ul style="list-style-type: none">• Service Corporation• Statutory Close Corporation• Benefit Corporations	Chapter 180 <ul style="list-style-type: none">• Subchapter XIX• Subchapter XVIII Chapter 204
Nonstock Corporation	Chapter 181
General Partnership (Including Limited Liability Partnership)	Chapter 178
Limited Partnership	Chapter 179
Limited Liability Company	Chapter 183

Governance

Entity Type	Statutory Provisions
Business and Nonstock Corporations	Governed by a board of directors, with officers acting under the board's authority. Shareholders are owners and elect the board, but do not control the corporation's activities.
Service Corporation	Same as business and nonstock corporations, except that all shareholders must be carrying on a particular profession with some sort of licensure.
General Partnership (Including Limited Liability Partnership)	Every partner has an equal right to participate in the management of the business.
Limited Partnership	General partners have the same rights and powers as a partner in a general partnership. The general partner manages the business. Limited partners do not manage but have limited voting rights.
Limited Liability Company	Unless the articles of organization vest management in managers, the default is that management is vested in members.

Liability Considerations

Entity Type	Scope of Liability
Corporations (Business & Nonstock)	A corporation—whether for-profit or not-for-profit, Subchapter C or Subchapter S—will generally limit the liability of its shareholders to the extent of their respective investments.
Service Corporation	Generally affords limited liability for obligations of the entity and the acts/omissions of other shareholders. However, does not protect against personal liability of a principal or agent for their own negligence/misconduct or that of others under their supervision and control.
General Partnership	Affords very little insulation from liability to its partners. Indeed, potentially more risk than a sole proprietorship because each partner may be liable for the acts and omissions of any other partner.

Liability Considerations

Entity Type	Scope of Liability
Limited Liability Partnership	Generally, a general partner of an LLP is only liable for obligations arising from his or her own activities and those of any person acting under their actual supervision and control.
Limited Partnership	Unlimited Liability for General Partner(s); Limited Liability for Limited Partner(s)
Limited Liability Company	An LLC will generally limit the liability of its members to the extent of their respective investments.

Organizational Documents

Entity Type	Organizational Documents
Business Corporations	Articles of Incorporation Bylaws Shareholder Agreement Shareholder List Consent Minutes Stock Certificates
Nonstock Corporation	Articles of Incorporation Bylaws Consent Minutes
General Partnership	Partnership Agreement
Limited Liability Partnership	Partnership Agreement Registration Statement
Limited Partnership	Partnership Agreement Certificate of Limited Partnership
Limited Liability Company	Articles of Organization Operating Agreement Member List Manager List Consent Minutes

Tax Treatment

Entity Type	Taxation
C Corporations	<ul style="list-style-type: none">• Subchapter C of the Internal Revenue Code• Double tax: earnings taxed at corporate level and distributions taxed at shareholder level• State and local tax deduction not capped• Federal rate: 21%• Payment of salaries deductible by corporation and taxable to recipient. Subject to FICA/Medicare taxes.• Shareholder tax on dividends and not deductible by corporation. No employment taxes.

Passthrough Tax Treatment

Entity Type	Taxation
S Corporations	<ul style="list-style-type: none">• Subchapter S of the Internal Revenue Code• No tax at entity level (unless Act 368 election made)• State and local tax deduction capped at \$10,000 (but consider an Act 368 election)• Income passed through and taxed to shareholders• Federal rate: 29.6% - 37% (depending on whether the sec. 199A 20% deduction applies)• Payment of salaries deductible by corporation and taxable to recipient. Subject to FICA/Medicare taxes.• Distributions generally are not taxable to the extent of the recipient's basis, no employment taxes• Losses deductible to the extent of basis
Partnership	<ul style="list-style-type: none">• Subchapter K of the Internal Revenue Code• No tax at entity level (unless Act 368 election made)• State and local tax deduction capped at \$10,000 (but consider an Act 368 election)• Income passed through and taxed to partners• Federal rate: 29.6% - 37% (depending on whether the sec. 199A 20% deduction applies)• Distributions generally are not taxable to the extent of recipient's basis (unless it is a guaranteed payment).• Losses deductible to the extent of basis• Partners are subject to self-employment tax (but not limited partners)
Disregarded Entities	<ul style="list-style-type: none">• The entity is disregarded, so the activities are treated and taxed as that of the owner

Effective Double Tax Rates

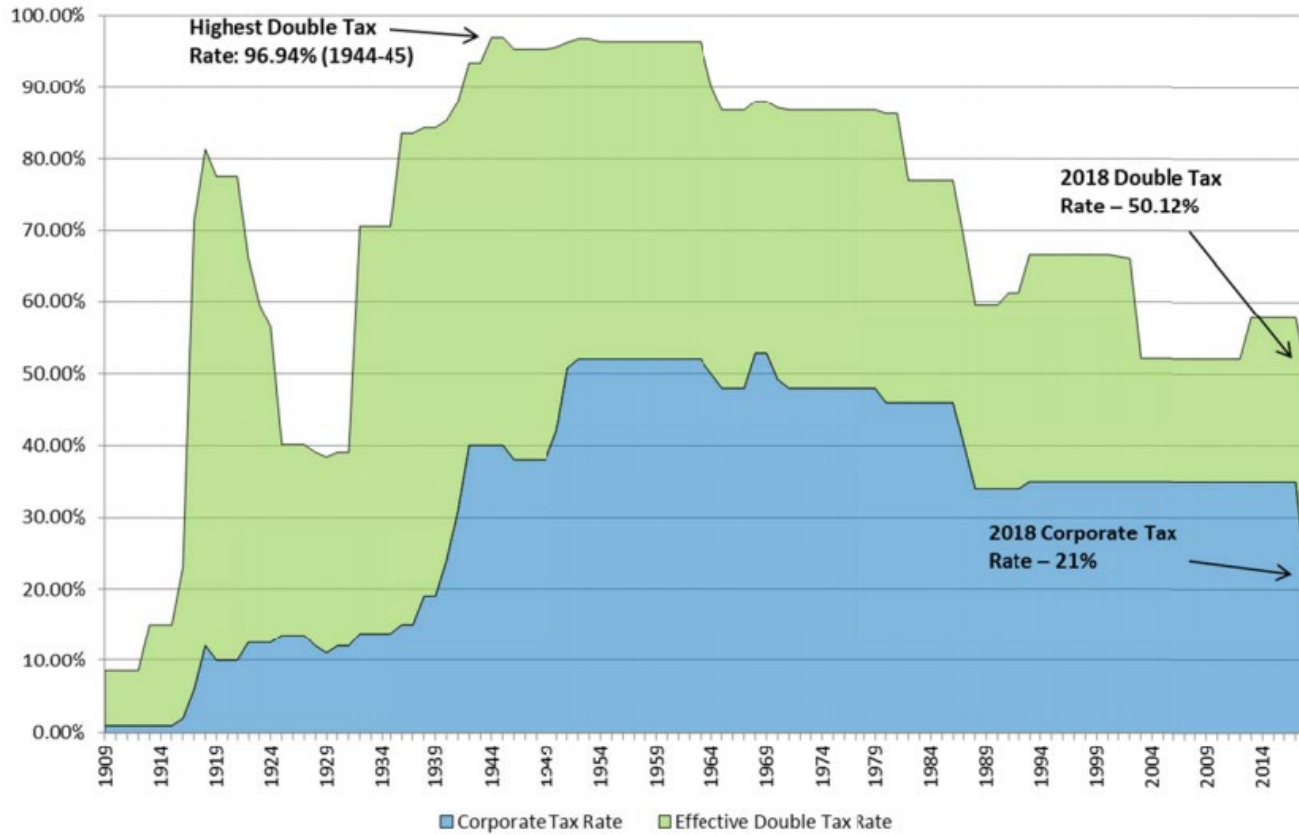


Illustration #1

Profitable Event Planning Business

Assumptions:

Owners in top tax bracket, over § 1411 FICA/SE tax threshold, active in business (non-trading) and paid reasonable compensation

Exemptions fully phased out, itemized deductions still reduced

Entity level earnings: \$1,000,000

Sale for \$10,000,000

Not a personal service corporation

Partnership income subject to self-employment tax

No basis at entity or owner level

No §1202 stock, but long-term capital gain

No state income tax

Owners qualify for simplified calculation of net investment income under Reg. § 1.1411-7(c) (\$10,000 portfolio income, \$990,000 trade or business income in each of last three years)

Marginal Tax on Additional \$100,000 of Income (2021)

	<u>C Corporation</u>		<u>S Corporation</u>		<u>Partnership/LLC/Sole Proprietorship</u>		
	Dividends	Wages	<u>Passive/Trading</u>	<u>Typical</u>	<u>SE Tax-Exempt</u>		<u>SE Taxable</u>
					Passive/Trading	Other	
Income	100,000	100,000	100,000	100,000	100,000	100,000	100,000
Corporate Income Tax	(21,000) ^a	(-0-)	(-0-)	(-0-)	(-0-)	(-0-)	(-0-)
Corporate FICA Tax	(-0-)	(1,429) ^b	(-0-)	(-0-)	(-0-)	(-0-)	(-0-)
	79,000	98,571	100,000	100,000	100,000	100,000	100,000
Individual Income Tax	(15,800) ^c	(36,471) ^e	(37,000) ^e	(37,000) ^e	(37,000) ^e	(37,000) ^e	(36,505) ^g
Individual FICA/SE Tax	(-0-)	(2,316) ^f	(-0-)	(-0-)	(-0-)	(-0-)	(3,509) ^h
Invest. Income Tax	(3,002) ^d	(-0-)	(3,800) ^d	(-0-)	(3,800) ^d	(-0-)	(-0-)
	60,198	59,784	59,200	63,000	59,200	63,000	59,986
Overall Tax Rate	39.80%	40.22%	40.80%	37%	40.80%	37%	40.014%

- a. 21%
- b. $1.45\% / 1.0145 = 1.429\%$
- c. 20%
- d. 3.8%
- e. 37%
- f. $1.45\% + 0.9\% = 2.35\%$
- g. $37\% \times (1.45\% / 3.8\% \times 3.509\%) = 36.505\%$
- h. $3.8\% \times (1 - 7.65\%) = 3.509\%$

Choice of Entity Example – Profitable Event Planning Business (2021)

	<u>C Corporation</u>	<u>S Corporation</u>	<u>Partnership\</u> <u>Sole Proprietorship</u>
Sales proceeds	\$10,000,000	\$10,000,000	\$10,000,000
Corporate Income Tax (21%)	(2,100,000)	(- 0 -)	(- 0 -)
	\$ 7,900,000	\$10,000,000	\$10,000,000
Individual Income Tax (20%)	(1,580,000)	(2,000,000)	(2,000,000)
Individual NII Tax (3.8%)	(300,200)	(3,800) (0.038%) ^a	(3,800) (0.038%) ^a
	\$ 6,019,800	\$ 7,996,200	\$ 7,996,200
Combined Tax Rate	39.80%	20.03%	20.03%

a $(\$10,000/\$1,000,000) \times 3.8\% = 0.038\%$

Illustration #2

Formation of Entity for Salon

Individual hair stylist operates her practice as a sole proprietorship

She is considering bring on additional stylists as employees

What type of entity do you recommend and why?

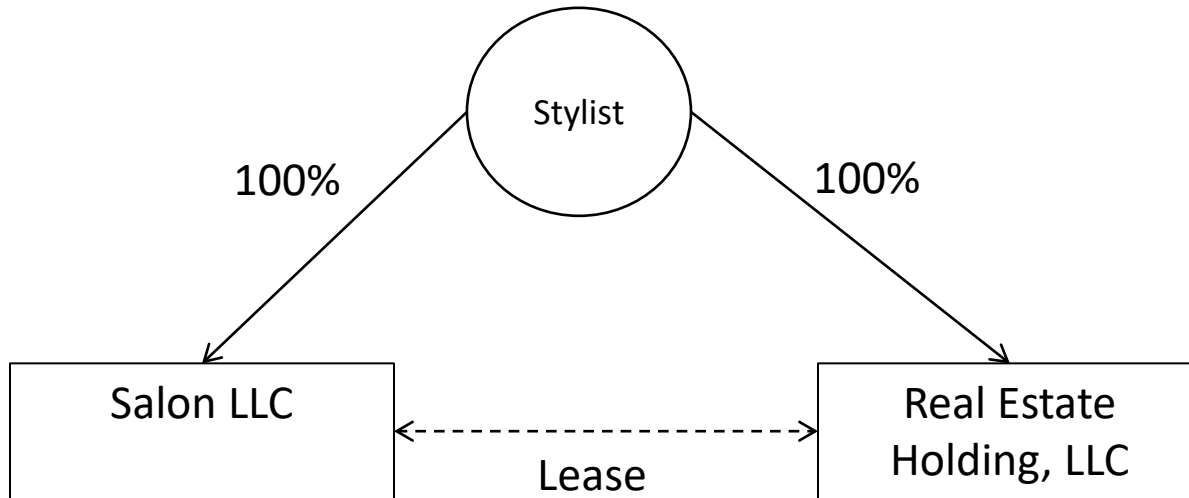
Illustration #3

Real Estate Acquisition for Salon

Same facts as Illustration #2. Now the stylist wants to buy the building in which she is currently renting salon space.

What type of entity do you recommend? Do you recommend a different entity for the acquisition of the real estate?

Illustration #3 (Cont.) Real Estate Acquisition for Salon



Thank You

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