

BOYAR  MILLER
ATTORNEYS AT LAW



A LAW TO THINK ABOUT

Entity Selection

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A LAW TO THINK ABOUT – Entity Selection

- What are the available forms of entity?
- Does one entity provide greater liability protection than another?
- How is each entity taxed?
- Why would I choose one over the other?
- How your entity selection might impact your sale?

Corporation

Shareholders



Corporation

Board of Directors
Officers

Taxation:

- Double
- Gross Margin Tax

S-Corporation

- Same as above

Taxation:

- Flow-Thru
- Gross Margin Tax

Restrictions:

- No more than 100 shareholders only individuals and certain trusts can be shareholders
- No foreign shareholders

Limited Liability Company

Members



LLC

Managers
Officers

Taxation:

- Flow-Thru
- Gross-Margin Tax

Limited Partnership

Shareholders | Members



Corporation or
LLC (GP)

Shareholders | Members
Directors | Managers
Officers

1%

99%

Limited
Partners

Limited
Partnership

Taxation:

- Flow-Thru
- Gross Margin Tax (formerly no Franchise Tax)

Corporation

Shareholders



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Corporation or
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Limited Partners

Limited
Partnership

Taxation:

- Flow-Thru
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Profits interests

- What are they?
 - Incentive Equity
 - Threshold Value
 - Vesting/Retention Tool
- Who can use? Unique tool for pass-thrus only
- Benefits and Consequences
 - Zero tax on issuance (but no compensation deduction as well)
 - Treated as a partner (guaranteed payments/self-employment tax)

Other tax considerations

- Double Taxation
- Self-Employment Tax
- Rule §1202 – “Small Business Stock”
 - C corporations only
 - Original Issue Stock only
 - Hold Period
- Simulated Equity (i.e. Phantom Stock, Stock Appreciation Rights)

How Will Entity Selection Influence Future Transactions?

- Equity Sale versus Asset Sale
 - Same for flow-thrus
 - “Hot Assets”
 - C corporation
 - Double tax on asset sale
 - Buyers’ desires – tax “step up” and no legal liability
- §338(h)(10)
 - Legally a stock sale, treated as an asset sale purely for tax purposes

Tax comparison example

	<u>Pass Through</u>	<u>2017 Corporation</u>	<u>Current Corporation</u>
Income	150,000	150,000	150,000
Tax Due at entity level (Max Rate)	-	(52,500)	(31,500)
Cash available after taxes paid	150,000	97,500	118,500
All money distributed to owners	150,000	97,500	118,500
Individual Tax Due			
Ordinary Income (highest 37%)	(55,500)		
Capital Gains Rate on Dividend (23.8%)		(23,205)	(28,203)
Net Cash	94,500	74,295	90,297
Total Taxes Paid	55,500	74,295	59,703

Tax overview

	“C” Corporation	“S” Corporation	LLC / Partnership
Pros	<ul style="list-style-type: none">• Lowest Direct Tax Rate (21%)• “Blocker” for Foreign Investors• Owners can receive W-2’s	<ul style="list-style-type: none">• Owners can receive W-2’s• No additional Medicare Tax	<ul style="list-style-type: none">• Flexibility• Tax Efficiency
Cons	<ul style="list-style-type: none">• Double Taxation• Not always tax efficient with restructurings	<ul style="list-style-type: none">• Strict rules and limitations	<ul style="list-style-type: none">• Owners can’t receive W-2’s

Additional considerations

- Chapter 38.001 Texas Civil Practice and Remedies Code:
 - “A person may recover attorney’s fees from an individual or corporation for breach of oral or written contracts.”
- Changing Order as Exclusive Remedy
 - LLC/LP - Yes
 - Corporation - No

Should I convert to a corporation?

So how do I decide?

- Goals Analysis:
 - Cash cow
 - Build and sell
 - Take advantage of Rule 1202
 - IPO

Questions?

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Tell us what you thought!
#ALawToThinkAbout @BoyarMiller