The Legal Strategist

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I am often asked by clients wanting to establish a new entity what are the differences between a limited liability company (LLC) and a corporation that has elected "S" status through the IRS. Therefore, for this quarter's topic, I have adapted the following brief description of the differences from an article which appeared in the Houston Chronicle.

The Feature Topic is a cursory review. If you would like more information on this, or any other topic previously covered in our newsletter, which can be viewed on *The Legal Strategist* tab of our web site, please contact our office to set up a consultation.

Scott Barrett

Texas Esoteric Facts

The first suspension bridge in the United States was the Waco Bridge. Built in 1870 and still in use today as a pedestrian crossing of the Brazos River.

Feature Topic: Choosing between an LLC or "S" Corporation

A limited liability company (LLC) is a special type of hybrid entity that combines the limited liability protection of a corporation with the tax and operational flexibility of a partnership. An S corporation is a special type of corporation that protects the personal assets of the company's owners while allowing the profits and losses of the company to "pass through" to the shareholder's personal income tax return. In reality, a S corporation is actually a C corporation that has elected to be taxed under subchapter S of the IRS Code.

Ownership
Owners of a limited liability company are known as "members" of the company, while "shareholder" is the term used to refer to the owner of an S corporation. Ownership in an S corporation is limited to 100 shareholders, while LLCs can have an unlimited number of members. Limited liability companies may have corporations, foreign entities, partnerships and other LLCs participating as members of the company. S corporation ownership is limited to individuals, certain trusts and estates. A person who is not a U.S. citizen or a resident alien of the U.S. cannot participate as a shareholder of an S corporation.

Taxes
Income earned by an LLC in excess of $400 is subject to self-employment taxes. S corporation shareholders are not required to pay self-employment taxes on distributions received from the company. In addition, an LLC has the ability to choose whether the company will be taxed as a corporation, sole proprietorship or a partnership. An S corporation is taxed according to Sub-chapter S of the Internal Revenue Code.

Equity
An S corporation may issue stock to potential investors. The S corporation may use capital raised from issuing stock as a means to finance expansion or pay off existing liabilities. However, an S corporation's ability to raise capital is limited, because the company can offer only one class of stock to potential shareholders. An LLC does not have the ability to issue stock to attract investors., but can offer membership. A drawback with membership is that it carries more weight as to the operations and liabilities of the business than a shareholder in an S corporation.

Salaries
Salaries must be paid to shareholders of an S corporation that provide services to the company. Shareholders who own more than 2 percent of an S corporation must pay taxes on salaries received from the company in exchange for services performed. LLC members are viewed as being self-employed but are not treated as employees of the LLC. Therefore, LLC members do not collect salaries from the company. Instead, the members take withdrawals.

Management
Owners of an LLC can choose to have members (owners) or managers to manage the LLC. When members manage an LLC, the LLC is much like a partnership. If run by managers, the LLC more closely resembles a corporation; members will not be involved in the daily business decisions. S corporations have directors and officers. The board of directors oversees corporate affairs and handles major decisions but not daily operations. Instead, directors elect officers who manage daily business affairs.

If you would like more information on the differences and appropriate uses of limited liability companies or S corporations, please contact Scott Barrett to set up a consultation.