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RightRisk™

RightRisk News

Dates to Remember

NAP Coverage (Spring-planted crops)
- county specific deadlines

Spring crop acreage reporting deadline
- July 15

Dairy Producers Previously Enrolled in LGM Program Now Eligible for 2018 Margin Protection Program

For more information see:
http://www.rma.usda.gov
http://www.fsa.usda.gov

How Much Risk is Right for You?

Structuring the Business for Tax Planning

Owners must decide what form of business entity to establish when beginning a business. The form of business will determine which income tax forms to use and whether the profits, losses, and other information will be held within the business entity or flow through to the owners. When choosing a form for the business, one should also carefully consider other goals, such as transition to the next generation, liability protection, allowing the business to grow, etc.

The primary consideration by owners when selecting a business entity or form is whether the business income, less applicable deductions and credits, should be taxed at the business entity level or passed through and taxed at the owner level. Income taxed at the entity level with profits or losses distributed to the owners will cause "double taxation." Income taxed at the owner level is called "pass-through income."

Sole proprietorships are not separate from the owners. The business is not a taxable entity from the Internal Revenue Service's (IRS) perspective. All business assets and liabilities are owned by the owner/operator. Thus, business income and deductible expenses are reported to the IRS by the owner.

Partnerships, as with sole proprietorships, are considered to be legally the same as the owners. However, a partnership must report business income, expenses, and related information to the IRS using Form 1065. Income is distributed to the partners as "pass-through" income and is reported on their individual tax returns. Thus, profits are taxed at the partners' individual tax rates.

C corporations are legally separate from their owners. As a result, C corporations must pay income taxes on profits earned by the business. Income generated by a regular corporation and distributed to the shareholders in the form of dividends and any salaries paid to the owners are taxed at the tax rates of the individual owners. Consequently, C corporation income is subject to "double taxation".

S corporations are separate legal entities created by a state filing. Such forms of corporation have a special election with the IRS to be treated like a partnership for tax purposes. S corporations must file a business tax return and provide each owner with a Form K-1 reporting the amount of income or loss generated and distributed (allocated among the stockholders in proportion to stock ownership) by the business. The profits or losses are "passed-through" to the owners and taxed at their individual tax rates.

The S corporation is viewed by some people as a way to reduce employment taxes. For example: an owner earns $120,000 in a sole proprietorship. This income is subject to self-employment taxes (social security taxes and Medicare taxes, adjusted) and income taxes. Conversely, the business may be converted to an S corporation and the owner takes $70,000 in "pay" and $50,000 in dividends. Income taxes would not change, but only the $70,000 would be subject to self-employment taxes. In certain cases, such as where little or no wages were paid, the IRS has treated the dividends as pay and thus subject to employment taxes.

Limited Liability Companies (LLCs) are also separate legal entities created by a state filing. The IRS treats an LLC like: (1) a partnership for tax purposes, (2) a sole proprietorship if the LLC has only one member-owner, (3) an S corporation, or (4) a corporation if the LLC has elected to be treated as such (most LLCs do not). Thus, LLCs have "pass-through" income in the first two situation or "double taxation" in the third situation.

The LLC must file a partnership tax return (Schedule 1065), provide each member-owner with a Form K-1, and distribute profits to the individual member-owners (may be disproportionately distributed among members to suit their individual tax situations). The income is then taxed at the member-owner's tax rate – either the individual or corporate rate, depending on the member-owner's tax reporting status. It is important to note that a state may accept an LLC's election to be taxed as a partnership and still impose an entity level tax on the LLC.

Changing Business Entity

It may be possible to change from one business entity to another, but there will most likely be tax consequences associated with the change. For example, there may be a tax on the liquidation of a corporation if it converts to an LLC. Similarly, a qualifying S corporation can be subjected to C corporation taxation on certain items without losing S status for other items. This happens when a C corporation converts to an S corporation and carries over appreciated property later sold at a gain.

In summary, business owners should consult with competent legal and accounting experts when selecting the structure type for their business. Not only do taxes vary by entity (and possibly by state), other factors should be taken into account such as owner needs, opportunities for business growth, liability protection, and succession and estate planning.

Comparison of Selected Business Entities for Taxation

Business Entity	Taxation	Typical Tax Forms
Sole Proprietorship	Income reported by owner	• Schedule F – farm income and expenses • Schedule C – business income and expenses • Form 1040 – individual tax return
Partnership	Income reported by owners – "pass-through" income	• Schedule F – farm income and expenses • Schedule C – business income and expenses • Form 1065 – return of partnership income • Form K-1 – partner's share of income, deductions, etc. • Form 1040 – individual tax return
C Corporation	Income reported and taxed at corporate rate. Second tax paid by owners if corporate income is distributed to owners in the form of dividends.	• Schedule F – farm income and expenses • Schedule C – business income and expenses • Form 1120 – corporate income tax return • Form 1040 – individual tax return
S Corporation	Income reported by owners – "pass through income"	• Schedule F – farm income and expenses • Schedule C – business income and expenses • Form 1120S – return of partnership income • Form K-1 – partner's share of income, deductions, etc. • Form 1040 – individual tax return
Limited Liability Company (LLC)	Income reported by member-owners – "pass-through" income	• Schedule F – farm income and expenses • Schedule C – business income and expenses • Form 1065 – return of partnership income • Form K-1 – partner's share of income, deductions, etc. • Form 1040 – individual tax return (in those cases where an owner is a corporation, or treated as a corporation for tax purposes, Form 1120 will be filed by the owner)

RightRisk™

RightRisk helps decision-makers discover innovative and effective risk management solutions.

- Education
- Coaching
- Research

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How much risk is right for you and your operation?

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