**Chapter 4 Notes**

**Entities Overview**

**Two Important Concepts from the Start –**

1. **Tax Calculation -** 2 required elements
2. **Concept of Corporate (Double or Multiple) Level vs. Flow-through (Single) Level**

**Entities Overview**

1. **Legal vs Tax Entities**
2. **Nontax Considerations**

**Types of Business Entities and Tax Treatment**

* Sole proprietorships
* Partnerships
* Corporations
  + S corporations
  + C corporations
* Limited liability companies
* Trusts and estates

*Sole Proprietorships –* taxed to owner

*Partnerships* – not subject to federal income tax.

*S Corporations* – generally not subject to federal income tax.

*C Corporations* – subject to federal income tax.

*Limited Liability Companies (LLCs)* – blends some corporate form advantages into a flowthrough entity

**II. Overview: Flow-Through Entities**

* + - * Also called pass-through entities
* Subchapter S: corporations whose owners elect to treat them as flow-through entities (discuss in chapter 9).

**III. Overview of Partnership Taxation**

*What is a partnership?*

*Types of Partners and Partnerships*

* partners are either general or limited partners
* general partners –
* limited partners –

General Partnership (GP):

Limited Partnership (LP):

Limited Liability Partnership (LLP):

Limited Liability Limited Partnership (LLLP): an extension of the LP form in which all partners (general and limited) have limited liability.

Limited Liability Company (LLC):

- combines corporate benefit of limited liability with partnership benefit of single level of tax

- owners are referred to as “members”

Partnership agreement

Operating agreement

* similar structure to a partnership agreement.

**See Table 1 summary template of flow-through entities at end of notes.**

**IV. Overview of Corporate Taxation**

* C corporations are taxed on their taxable income at corporate rates.
* Prior to the Tax Cuts and Jobs Act (TCJA) taking effect (pre-2018), a corporation’s income was taxed at different rates depending on where the corporation’s taxable income fell in the corporate tax rate schedule – up to 35% (39% incremental)
* Post-TCJA, corporate tax rate fell to a flat 21% for tax years beginning in 2018.

*Types of Shareholders*

* *Dividends Received Deduction (DRD)*

|  |  |
| --- | --- |
| **Receiving Corporation’s Ownership Percentage** | **Dividends Received Deduction Percentage** |
| Ownership % < 20% | 50% |
| 20%<= Ownership % < 80% | 65% |
| Ownership % >= 80% | 100% |

Example: Blue Corp. owns 15% of Red Corp. Red Corp. pays a $40,000 dividend this year to Blue Corp. What is Blue Corp.’s dividend received deduction? How does your answer change if Blue Corp. owns 40% of Red Corp.?

*Deductibility of Losses*

* Net Operating Loss (NOL)
* NOLs generated before 2018:
* NOLs generated in/after 2018:

Carryback amends prior tax return and generates an immediate refund

**TABLE 1**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **SUMMARY OF FLOW-THROUGH ENTITY TYPES** | | | | |
| **Type of entity** | **Type of owners** | **Are owners liable for entity debts?** | **May owners participate in entity management?** | **Types of businesses operated by entity\*** |
| General partnership (GP) | General partners only | Yes, recourse to general partners  No, debt secured only by property | Yes | Operating businesses, and joint ventures formed by other operating businesses |
| Limited partnership (LP) | Limited partners plus at least on general partner\*\* | Yes, for general partners  No, for limited partners | Yes, for general partners  No, for limited partners | Entities raising capital from investors |
| Limited liability company (LLC) | Members have some general and some limited characteristics | No | Yes, generally, but many operating agreements limit participation by some member classes | Operating businesses, non-professional service businesses, and some professional service businesses |
| Limited liability partnership (LLP) | General partners with limited liability for malpractice committed by other partners. | Yes, for general liabilities, but only responsible for their own malpractice | Yes | Professional service entities such as accounting and law firms |

\* In general; permitted business operations depend on state law.

\*\*The general partner is often a C corporation or LLC, to minimize exposure to entity liabilities.