



Overview

Certain tax issues arise when distributing assets, including cash from a business. The type of entity the business is organized as largely determines what the tax consequences will be. C corporations, S corporations, partnerships, and sole proprietorships each have certain business advantages and disadvantages and are taxed differently. A limited liability company (LLC) can elect whether it will be taxed as a C corporation, S corporation, partnership, or, if it has only one member, a sole proprietorship. A sole proprietorship is disregarded as an entity for tax purposes, and all property of the business is owned by the sole proprietor.

Taxation of Income and Transfers of Cash or Property from Various Business Entities

	C Corporation	S Corporation	Partnership/LLC*
Income Taxation in General	<ul style="list-style-type: none"> Corporation pays income tax if it has taxable income. Compensation paid is deductible, if reasonable. May be subject to Corporate Alternative Minimum Tax (CAMT) due to increase in insurance cash value and receipt of death proceeds. 	<ul style="list-style-type: none"> S Corporations do not pay income tax. All earnings and losses are passed through to the shareholders. Flow through amounts are reported on shareholder Form K-1; income taxable to Shareholder but not subject to FICA. Compensation paid to an employee is subject to FICA. 	<ul style="list-style-type: none"> Partnerships do not pay income tax. All earnings and losses are passed through to the partners. Partners pay self-employment tax on their share of partnership income, assuming they are active in the partnership.
Cash Distributions	<ul style="list-style-type: none"> Dividends are taxable at 15% (currently) to shareholder to the extent of earnings and profits (E&P). Dividends are not deductible. 	<ul style="list-style-type: none"> Distributions from AAA (if former C corp) - not taxable but reduces shareholder's basis. Distributions from E&P (if former C corp) does not reduce basis but is taxable to shareholder. Capital Gain – distributions in excess of basis are capital gain. 	<ul style="list-style-type: none"> Return of Basis – not tax to partner, but his/her basis is reduced by distribution. Capital Gain – distributions that exceed partner's basis are subject to capital gain.

	C Corporation	S Corporation	Partnership/LLC*
Distributions of Appreciated Property** – Business Taxation	<ul style="list-style-type: none"> • Gain (FMV – Basis) is taxable to corporation.*** • Property distributed as compensation is deductible, if reasonable. Gain is offset by deduction. • Property distributed as dividend, is nondeductible to corporation. 	<ul style="list-style-type: none"> • Gain (FMV – Basis) is taxable to shareholders.*** • Property distributed as compensation is deductible, if reasonable. Gain is offset by deduction. • Built-in gains (recognized from sale or distribution of prior C corp. property) taxable to S corp. at highest C corp. rate. 	Gain is generally not recognized on distribution; it is recognized at the time of sale by distributee partner.
Distributions of Appreciated Property – Owner / Employee Taxation	<ul style="list-style-type: none"> • Taxable amount is property's FMV. • If dividend, taxable at 15% (currently). • If compensation, taxed as ordinary income at the shareholder's marginal rate. 	<ul style="list-style-type: none"> • Compensation – taxable at shareholder's marginal rate. • Distributions from AAA (if former C corp.) – not taxable but reduces shareholder's basis. • Distributions from E&P (if former C corp.) does not reduce basis but is taxable to shareholder. • Capital Gain – distributions in excess of basis are capital gain. 	<ul style="list-style-type: none"> • Gain generally not recognized on distribution; it is recognized at the time of sale by distributee partner. • AMT may be recognized by partner. • Partner's basis is reduced by distribution.

* A limited liability company (LLC) may elect to be taxed as a corporation (C or S), partnership, or, if it only has one member, a sole proprietorship. Usually, an LLC elects to be taxed as a partnership, although there is a compelling reason to be taxed as an S corporation if the LLC operates an active trade or business. The owner of an LLC taxed as a partnership is not an LLC employee and is subject to employment taxes (SECA) on all distributions from the LLC. In contrast, an S corporation owner who performs more than minor services for the S corporation will be classified as both an employee and an owner, and will be subject to employment taxes (FICA) only on reasonable wages paid by the S corporation. Thus, being classified as an employee will provide the owner with an opportunity to avoid paying employment taxes on any S corporation dividend income.

** Gain on appreciated property is its Fair Market Value (FMV) in excess of tax basis (net cost).

*** Gain on appreciated property is usually capital gain; but, a life insurance policy with appreciation will yield ordinary income, plus, if the policy is sold, a capital gain to the extent the sales price exceeds the policy's surrender value.



FERRIS FINANCIAL, LLC

HELPING YOU PLAN, PROTECT & PROSPER



Ferris Financial, LLC

Matthew Ferris*, MBA

150 E. Mound Street, Suite 301, Columbus, OH 43215

Phone: (614)227-7090

msferris@ferris-financial.com

*Registered Representative offering securities through NYLIFE Securities LLC, Member FINRA/SIPC, a Licensed Insurance Agency, (150 E. Mound Street, Suite 301, Columbus, OH 43215). Financial Adviser offering investment advisory services through Eagle Strategies LLC, a Registered Investment Adviser. Member Agent of The Nautilus Group®, a service of New York Life Insurance Company. Ferris Financial, LLC is not owned or operated by New York Life Insurance Company or its affiliates.

This tax-related discussion reflects an understanding of generally applicable rules and was prepared to assist in the promotion or marketing of the transactions or matters addressed in this material. It is not intended (and cannot be used by any taxpayer) for the purpose of avoiding any IRS penalties that may be imposed upon the taxpayer. Ferris Financial, LLC as well as New York Life Insurance Company, its agents and employees may not give legal, tax or accounting advice. Please consult your own professional advisors before making any decisions.

This information was produced by New York Life Insurance Company and provided as a courtesy by Matthew Ferris. © 2016 New York Life Insurance Company. All rights reserved. SMRU 1640267-TNG (exp. 08.31.19)

Matthew Ferris CA Insurance License Number 0K38071