Choosing the best tax entity for a small business

Choosing the Best Tax Entity for a Small Business Joseph Anthony's article " Pick the business entity that's right for you" outlines the pros and cons of various tax entities for small businesses. Ultimately, Anthony concludes that " there is no 'best' entity choice for small businesses," citing the fact that if one entity were conclusively superior to others, there would be more agreement amongst small businesses. Accordingly, instead of arguing for the supremacy of one type of business entity, Anthony provides a concise evaluation of the pros and cons of " sole proprietorships, general partnerships, S corporations, C corporations and Limited Liability Companies."

The main advantage of sole proprietorships is that it is the simplest to understand, start, and get out of. For this reason, the article recommends this type of entity to first time business owners. On the negative side, however, sole proprietorships face " unlimited personal liability" and " 15. 3% self-employment tax on all earnings up to $80, 400." If the business is legally risky, the personal liability issue is a major obstacle.

A general partnership, on the other hand, is characterized by Anthony as " a good way to participate in a venture with other individuals without having to deal with payroll issues." The partners also have great freedom in the distribution of profits amongst themselves as long as a consensus is reached. Nevertheless, this entity shares the problem of self-employment tax with sole proprietorships, and all partners can be held liable for the actions of the others.

The central benefit of an S corporation is that there is " no Social Security or Medicare taxes on profits or dividends from the corporation to shareholders." However, the business owners' benefits are not deductible. In a C corporation, on the other hand, all health insurance is deductible, and there is access to a lower tax rate for profits kept in the corporation. Nevertheless, Anthony notes that the negatives to a C corporation are that " if the corporation loses money, you don't get to deduct it on your personal tax returns; if profits that have been already taxed at the corporate level are later distributed to you as dividends, you'll have to again pay tax on that money." Additionally, both types of corporations have the added negative of payroll paperwork. Both, however, share the bonus of limited liability for the partners.

Finally, a limited liability company combines the benefits of partnerships and corporations, providing owners with " the limited liability features of a corporation combined with the income-splitting flexibility of a partnership." The downside of this type of entity is also that of partnerships, namely, self-employment taxing. And finally, some " lawyers worry that there is little case law for what happens when an LLC formed in one state gets sued for something that happens in another state." This could be problematic for a company with wide reaching business practices.

Overall, Anthony's article does not seem to lean one way or the other in terms of one type of entity being the best. Each type of entity has pros and cons that could tend to favor different types of businesses. Furthermore, it depends on the needs and goals of the owners. Nevertheless, Anthony's article provides a helpful glimpse into the different tax entities from which a small business can choose, giving an objective perspective on each type of entity.

Works Cited

Anthony, Joseph. " Pick the business entity that's right for you." Microsoft Small Business Center. 3 December 2006 .