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California LLC vs. S Corp: The Tax Pros and Cons

Small businesses often chose to operate as California S Corps because of tax advantages. In some cases, California LLCs can be more favorable. Which is best?

California LLC vs. S Corp The Tax Pros and Cons

LONG BEACH, CA, UNITED STATES, September 1, 2020 /EINPresswire.com/ -- For some time now, owners of small businesses have chosen to operate as California S Corps because of the included tax advantages. As compared to a C corporation, there is no federal-level double taxation. Due to the changes made as a result of the TCJA (Tax Cuts & Jobs Act of 2017), the business owners may want to rethink how to structure their business. In certain situations, a California LLC can be a more favorable structure compared to an S Corp. So, what should you know about a California LLC vs. an S Corp? Which is the better choice for you?

What is an LLC and an S Corp?
LLCs are Limited Liability Companies. The owners are not liable personally for any of the company's liabilities or debts. Instead, they are hybrids that combine the best qualities of corporations with sole proprietorships or partnerships. LLCs do not pay taxes themselves. Instead, they pass the losses and profits to the personal tax return of the owner. They also consider wages to be an operating expense. Therefore, a company deducts them from its earnings.

S Corps are corporations that satisfy specific IRC requirements. Corporations with 100 or fewer shareholders can incorporate and still have tax classifications as partnerships. Corporations must have corporate officers and boards of directors. S Corps, most significantly, pass their income directly to shareholders and avoid double taxation. Businesses such as insurance and financial companies and companies handling domestic and international sales cannot be S Corp classified.

LLCs – The Pros and Cons
Pros:

Business owners are not personally liable for business lawsuits or debts.

There are fewer recordkeeping and reporting requirements.

Businesses can avoid double taxation. LLCs' income, deductions, and credits will flow through to the owners and reported on the owners' tax returns.
Owners of LLCs may be eligible for QBIs (qualified business deduction).

Owners can use their distributive share of the LLCs' qualified nonrecourse liabilities and recourse liabilities as a tax basis to deduct the pass-through losses and take cash distributions.

Cons:

LLCs may dissolve upon the bankruptcy or death of a member.
LLCs are not the logical choice if the owner's main objective is to be a publicly-traded company.
There are federal level high taxes for self-employment.
Regulated professional fields cannot register as LLCs.

S Corps – The Pros and Cons

Pros:

Shareholders receive corporate losses, deductions, credits, and incomes. This allows the company to avoid double taxation.
A company can establish credibility with potential suppliers, investors, employees, and customers.
Companies can transfer interest with no adverse tax consequences.
Shareholders can become employees, earn a salary, and receive tax-free dividends.
Owners of S corps may be eligible for QBIs (qualified business deduction).

Cons:

There is increased scrutiny by the IRS.
Noncompliance issues, such as mistakes in notifications, consent, election, filing, or stock ownership, may lead to the S Corp's termination.
It requires extra money and time.

Shareholders can only use their direct loans to the S corp. as their tax basis. They do not get a tax basis for the loans from the banks or any other outside third party even if the loans are personally guaranteed by the shareholders.

Which Option is Right for My Business in California?
You need to decide whether a California S Corp or California LLC is right for your business. A

California LLC will be subject to the annual minimum tax of $800, plus the LLC fee on gross receipts if the LLC's California gross receipts exceed the threshold. An S Corp will be subject to 1.5% of California S Corp with an annual minimum tax of $800. All the factors should be carefully considered before a decision is made.

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