

SIDE-BY-SIDE COMPARISON OF TEXAS ENTITY CHOICE

This table compares the entity choices by looking at issues (both tax and nontax) that generally are considered significant when selecting the type of entity to use for a new business, or to convert to for an ongoing business. Note that any Texas entity can convert to another business form quite easily and inexpensively; and any business can select corporate taxation, although a corporation cannot select any other.

State Law Matters

Type of Texas Entity Form

Issue	Corporation	Partnership	LLC	Sole Proprietorship
Limited liability for owners?	Yes.	No for general partners, yes for limited partners. Yes, substantially, for general partners in the LLP form of partnership.	Yes.	No. Liability is unlimited.
Texas franchise tax paid? [But not payable by any entity with gross revenue of less than \$300,000.]	Yes.	Yes. A general partnership of only individuals does not pay. Passive activity partnerships do not pay.	Yes. LLC pays the franchise tax, even if it is federally taxed as a partnership or disregarded.	No.
Flexible ownership and capital structure?	Yes. (However, tax rules may change this, if choose to be taxed as S Corp.)	Yes. Need at least two persons; however, these can be husband and wife.	Yes. (However, tax rules may change this, if choose to be taxed as S Corp.)	N/A – one owner.
Continuity of life for entity?	Yes.	Yes.	Yes.	No.
Centralized management of entity?	Yes.	No for general partnership; usually yes for limited partnership.	Yes or no by choice.	N/A – one owner.
Free transferability of ownership interests?	Yes, but may be limited by a buy/sell or by S Corp rules.	Generally, no.	Yes or no by choice; may be limited by a buy/sell or when choosing to be taxed by S Corp rules..	No, but as a practical matter the entire business may be sold.
Degree of administrative complexity?	High.	Moderate, except high for a limited partnership.	Moderate to low.	Low.
Certainty of legal and tax outcomes?	High.	Moderate to high.	Moderate.	High.
Creditor can obtain an ownership interest upon judgment for personal debt?	Yes. Economic and voting interest saleable upon execution. For a one-owner business, a creditor or bankruptcy trustee can obtain sale of all assets of the corporation	General partnership: Yes. Economic interest saleable at execution. Limited Partnership: No execution. Charging order, then possible sale of economic interest (not voting) after receivership.	No execution. Charging order. No direct statutory authority for sale. Voting interest not saleable. But, for a one-owner business, a bankruptcy trustee can obtain sale of all assets of the LLC.	Yes. Direct sale of business (and all other, non-exempt) property upon execution.

Federal Tax Matters

Type of Federal Taxation

Issue	Sub-Chapter C "C Corp"	Sub-Chapter S "S Corp"	Sub-Chapter K "Partnership"	Disregarded Sole Proprietorship
Double taxation of income?	Yes, except for qualified small business corps.	No, unless former C corp. and built-in gains and certain other taxes apply.	No.	No.
Tax treatment of fringe benefits for owners?	Good.	Poor, if own more than 2% of stock.	Poor.	Poor.
Flexibility to select tax year?	Yes.	Limited.	Limited.	Limited. [See Jerome H. Vance, TC Memo 1989-95, (1989).]
Passive loss rules apply?	No, unless a personal services corporation (PSC) or closely held corp.	Yes – at shareholder/member level.	Yes – at partner/member level. Treatment of limited partners is unfavorable; treatment of members is unclear.	Yes.
Loans against qualified plan accounts possible for owners?	Yes.	No, if own more than 5% of stock.	No, if own more than 10% of profits or capital interest.	No.
Favorable tax rate on long-term capital gains?	No, regular corporate rates apply.	Yes, generally 10% maximum.	Yes, generally 10% maximum.	Yes, generally 10% maximum.
Double taxation upon liquidation?	Yes.	Not usually, but possible.	No.	No.
Personal holding company tax applies?	Yes.	No.	No.	No.
Accumulated earnings tax applies?	Yes.	No.	No.	No.
Unreasonable owner compensation issue applies?	Yes, for being too high (attempt to avoid double taxation of dividends).	Yes, for being unreasonably low compensation (attempt to avoid payroll tax by shifting compensation from salary to dividends).	No. But, since \$90,000 of general partner revenue is subject to payroll tax, some tendency to LPs and LLCs exists in planning choice.	No.
Treatment of gain on sale of ownership interest?	Generally, capital unless collapsible corporation (IRC Sec. 341).	Capital.	May be part ordinary under "hot assets" rules. (See IRC Sec. 751.)	May be part ordinary due to recapture items.

Issue	C Corp	S Corp	Partnership	Sole Proprietorship
Limitations on use of cash method?	Yes, but smaller corporations and PSCs can use cash method.	No, unless more than 35% of losses are allocated to "limited entrepreneurs."	No, unless more than 35% of losses allocated to limited partners.	No.
Limitations on use of NOLs and other "tax attributes" after ownership change?	Yes.	N/A. Losses pass through to owners.	No, but Alternative Minimum Tax information (AMT) must be provided to partners/members.	No, but AMT information can affect owner's tax amount due.
Potential ability to reduce payroll taxes of owner-employees?	No, but those taxes are paid only on true salary.	Yes, within limits of reasonableness. (Note that much of the advice in this area leads to illegality).	Yes, through use of limited partnership.	No, but may benefit from employing owner's children under age 18.
Potential favorable treatment of owner-level interest expense on debt to inject capital or acquire ownership interest?	No.	Yes.	Yes.	Yes.
Additional owner-level tax basis from entity-level debt (for loss deduction purposes)?	No.	No, even if owner guarantees debt.	Yes, but see IRC Secs. 704(c) and 737(b).	N/A, but owner gets basis from debt since no entity exists.
Basis adjustments upon purchase of ownership interest?	No.	No.	Yes, but see IRC Sec. 732(c).	N/A.
High ability to make tax-free contributions and distributions?	No.	No.	Yes.	Yes.
Ability to make special tax allocations among owners?	No.	No.	Yes.	N/A.
Ability to shift entity income among family member owners?	No.	To a degree, by manipulating wages of employee-owners.	Yes, within limits of family partnership rules.	Yes, by employing family members.
Treatment of loss on sale of ownership interest?	Capital, unless stock is Section 1244 stock.	Capital, unless stock is Section 1244 stock.	Capital.	Depends on nature of assets sold.