Business Entities

There are several ways a small business can be treated.

Sole Proprietor— This is the least expensive way to establish your business. There are no fees to pay to set up a sole proprietor business. Your income and expenses are reported to the IRS on a Schedule C as part of your regular 1040 tax return. It is recommended that you obtain a Employer Federal Identification Number (EFIN) so you can give this number to other business rather then your social security number. You should also fill out the paperwork with the Lake County Clerk's office Assumed Business Name forms. Forms can be found on their website at http://lakecountyil.gov/CountyClerk/VitalRecords/PublicFilings/AssumedBusinessNames.htm or see the forms at the back of this booklet.

Partnership - A partnership is the relationship existing between two or more persons who join to carry on a trade or business. Each person contributes money, property, labor or skill, and expects to share in the profits and losses of the business.

A partnership must file an annual information return to report the income, deductions, gains, losses, etc., from its operations, but it does not pay income tax. Instead, it "passes through" any profits or losses to its partners. Each partner includes his or her share of the partnership's income or loss on his or her tax return.

Partners are not employees and should not be issued a Form W-2. The partnership must furnish copies of Schedule K-1 (Form 1065) to the partners by the date Form 1065 is required to be filed, including extensions. Partners pay self-employment tax on the profits of the business as shown on the K-1.

Limited Liability Company (LLC) - An LLC can be treated as a Sole Proprietor, Partnership, S-Corp or a C-Corp. Although the LLC offers some corporate protection it can be pierced by a lawyer if it is not being treated properly by the owner. Tax filing is dependant on how the LLC is treated. An LLC can have less paperwork than an S or C corporation.

Corporations - C-Corporations vs. S-Corporations - An eligible domestic corporation can elect to be taxed as an S-Corporation. An S-Corporation generally does not pay Federal income tax-its profits and losses pass through directly to shareholders. This avoids the C-Corporation double tax , and allows shareholders to deduct corporate losses on their individual returns.

	SOLE PROPRIETOR	LLC	C CORPORATION	S CORPORATION
Taxation	Schedule C income would be taxed at the personal rate plus social security rate at 15.3% (self employment tax) .	Schedule C income would be taxed at the personal rate plus social security rate at 15.3% (self employment tax) .	Double tax of profits. Income is taxed at the corporate level ($0-50,000 of profit is taxed at 15%); profits distributed as dividends are tax at the individual	Profits are passed though directly to shareholders, escaping corporate-level tax.
Dividends	Not applicable	Not applicable	Dividends paid by C Corporation are generally taxed to the individual at the same rate as long-term capital gains (0% or 15%).	S Corporation earnings passed through to a shareholder are taxed as ordinary income.
Ordinary Losses	Losses from the business reduces other income on the individual tax return.	Losses from the business reduces other income on the individual tax return.	C Corporation losses are not passed through to shareholders. Losses can be deducted only at the corporate level as NOL (Net Operating Loss) carrybacks and carryforwards.	Losses are passed through directly to shareholders. Current – year losses are deductible up to the shareholders basis in the S Corporation stock and loans to the S Corporation
Capital Gains	Not applicable	Not applicable	Taxed at the same rate as ordinary income.	Pass through to shareholders and are eligible for favorable capital gain tax rates for individuals

	Sole Proprietor	LLC	C CORPORATION	S CORPORATION
Capital Losses	Not applicable	Not applicable	Allowed only to the extent of capital gains. Met capital losses are carried backed 3 years and forward 5 years.	Pass through to shareholders. Capital losses are deductible subject to limitations on the shareholder's return.
Payroll Requirements	None required unless there are employees. If there are W-2 wage earners then the paperwork is the same as a corporation.	None required unless there are employees. If there are W-2 wage earners then the paperwork is the same as a corporation.	Owner is an employee of the corporation and must take W-2 wages. Corporation must file unemployment for all employees. Payroll withholdings are required to by electronically deposited to the IRS on the 15th of each month. Payroll (quarterly reports) are to be reconciled and filed with the IRS every 3 months.	Owner is an employee of the corporation and must take W-2 wages. Corporation must file unemployment for all employees. Payroll withholdings are required to by electronically deposited to the IRS on the 15th of each month. Payroll (quarterly reports) are to be reconciled and filed with the IRS every 3 months.
Owners Draw	Allowed	Allowed	Not allowed	Not allowed