Entity Types Explained: How to Pick the Best Structure for Taxes and Growth

Your choice of legal structure, C corporation, S corporation, Partnership or LLC has a lasting impact on how much you pay in taxes and how you manage profits.

Over the last several years, there's been major tax legislation which has caused many people to revisit this topic. For example, the flat 21% corporate tax rate continues to make the C corporation an attractive option for some but the long-standing issue remains, profits from a C Corp can be taxed twice: first at the corporate level, and then again when distributed to shareholders. So if you're distributing most of your profits each year, there may be a higher tax cost as a C Corp versus the other options.

Pass-through entities, which would be S corps, LLCs and partnerships, offer an alternative by allowing the income to pass directly to the owners, so it's only taxed once at each owner's individual marginal tax rate. Within the same law that cut the C Corp rate from 35% to 21%, qualifying pass-through entities were provided a new Qualified Business Income (QBI) deduction, which means the owners have to only pay tax on 80% of the income that's passed through to them.

Each structure has advantages and tradeoffs. The best fit for you, it'll depend on many factors, such as how your business operates, the entity types of the owners or the investors, whether you plan to retain or distribute your earnings from the entity each year, and also the number of owners and frequency of ownership changes, and finally, maybe how many states you operate in. It's quite possible that there's a structure that is worse from a tax cost perspective, but maybe much better from a compliance cost or legal perspective.

So that said, there's never a clear-cut winner without first considering the many non-tax factors in play. Whether you're in manufacturing, professional services, real estate development, or any other industry, your entity type will affect your tax obligations, financing options, and even how your business is valued in a sale or succession plan.

So, the truth is, your business structure isn't set in stone. The best entity choice for you may be different during the early years of your business versus the later years, which is why we recommend a periodic review, especially as your goals evolve, to help make sure you're maximizing tax efficiency while staying aligned with your long-term business strategy.