

Are you in the process of starting a business or contemplating changing your business entity? If so, you'll need to decide how to organize your company. Should you operate as a C corporation or as a pass-through entity, such as a sole proprietorship, partnership, limited liability company (LLC), or S corporation?

Organizing your business as a C corporation may reduce the federal income tax on your business's income. A **C corporation** is currently taxed at a flat 21% rate. With a pass-through entity, income the business passes through to you is taxed at individual rates, which currently range from 10% to 37%. So, if you choose to organize as a C corporation, the overall rate may be lower than if you operate the business as a pass-through entity.

More to consider

There are other tax-related factors you should take into account.

For example:

Will most of the business profits be distributed to the owners?

If so, it may be preferable to operate the business as a pass-through entity, since C corporation shareholders will be taxed on dividend distributions from the corporation (double taxation). Owners of a pass-through entity will be taxed only once on business income, at the personal level.

Does the business own assets that are likely to be appreciated?

If so, it may be better off to operate as a pass-through entity to avoid a corporate tax when the assets are sold or the business is liquidated. This is because there is no step up in tax basis for assets owned by an entity.

For a business that is a pass-through, the owner's basis is stepped up by an owner's interest in the entity. That can result in less taxable gain for the owner when his or her interests in the entity are sold.

Is the business expected to incur tax losses for a while?

If so, you may want to structure it as a pass-through entity. You can deduct the losses against other income. Conversely, if you have insufficient other income or the losses aren't usable (for example, because the passive loss rules limit them), it may be preferable for the business to be organized as a C corporation since it'll be able to offset future income with the losses.

Is the business owner subject to the alternative minimum tax (AMT)?

If so, it might be better to organize as a C corporation, since corporations aren't subject to AMT. AMT rates on individuals are 26% to 28%.

The QBI deduction provides relief for pass-through entities.

Currently, the corporate federal income tax is a flat 21% rate and individual federal income tax rates begin at 10% and go up to 37%. The difference in rates can be alleviated by the qualified business income (QBI) deduction, which is available to eligible pass-through entity owners who are individuals, and some estates and trusts.

The QBI deduction is scheduled to expire in 2026, unless Congress acts to extend it, while the 21% corporate rate is permanent. Also, noncorporate taxpayers with modified adjusted gross incomes above certain levels may be subject to an additional 3.8% tax on net investment income.

Contemplate the issues

Many factors are involved in determining which entity type is best for your business. This only covers a few of them. [Contact us](#) for details about your situation.

You Might Also Like

- [Is an LLC Right For Your Small Business?](#)
- [Own a pass-through entity? Beware the Ides of March](#)