What are some other business entities and what are the tax consequences of distributions from these businesses?

In addition to C corporations, S corporations, partnerships, and sole proprietorships, four other business entities are particularly common: limited liability companies (LLCs), limited liability partnerships (LLPs), limited partnerships (LPs), and professional corporations (PCs). When forming one of these entities, it is important for you to know the tax consequences if your business distributes cash or property to its owners. Sometimes distributions are included in the taxable income of the business owner, and sometimes they are not. You should also be aware of the impact (if any) on tax basis.

Impact on specific business entities

Tax treatment will vary, depending on the type of business entity you select.

Limited liability companies (LLC)

A limited liability company is a business entity created and regulated under state law. LLC laws allow companies that operate as partnerships to benefit from the limited liability characteristics of corporations. This means that LLCs give their owners, who are called "members," protection from the claims of business creditors. The liability of an LLC member for business debts is generally limited to the value of his or her individual ownership interest in the LLC. Moreover, unlike limited partners in a limited partnership, all LLC members can take an active role in the operation of the business without exposing themselves to personal liability.

For federal tax purposes, the LLC can choose to be treated as a partnership or as a corporation. In general, LLCs choose to be taxed according to partnership rules to avoid the double taxation imposed on C corporations. Therefore, it is a good idea to review the partnership tax rules. Distributions from a partnership occur when a partnership makes a payment of cash or property to its partners, based on their ownership interests. Withdrawals

from a partnership are initially treated as a nontaxable return of your partnership investment. Only after you have recovered your entire investment (in other words, only after your tax basis has been reduced to zero) will any further partnership withdrawals be taxable to you. Each partner has a unique tax basis in his or her partnership interest, representing the amount of the partner's investment in the partnership. The tax basis for each partner is typically adjusted throughout the life of the business. Withdrawals decrease a partner's tax basis, while contributions increase it.

Limited liability partnership (LLP)

Most states allow certain professionals (such as doctors, lawyers, and accountants) to form an entity similar to the limited liability company. This entity is called a limited liability partnership (LLP) . An LLP is a partnership organized under state statutes that gives a degree of liability protection to individual partners. Partners in a general partnership are liable for all partnership obligations, including the negligence or malpractice of other partners. Once an LLP business is properly registered, however, the partners of the LLP do not have liability for the malpractice of the other partners but still remain liable for their own acts.

For federal tax purposes, an LLP follows the same entity classification rules as the LLC. That is, it can elect to be taxed as a corporation or as a partnership. Most LLPs choose to be taxed as partnerships, however.

Limited partnerships (LP)

A limited partnership (LP) is defined as a partnership with one or more general partners and one or more limited partners. General partners are liable for all partnership debts and obligations, whereas a limited partner is only liable for the value of his or her individual ownership interest in the partnership. Although LPs are similar to LLCs and LLPs, there are a number of differences as well. For instance, although most states forbid limited partners from participating in management decisions, LLC members are free to participate in management.

Basically, LPs are taxed as partnerships for federal tax purposes.

Professional corporations (PC)

Professional corporations (PCs), or qualified personal service corporations (as they are sometimes called), are a special type of corporation composed of professionals. Under the federal tax code, a qualified personal service corporation is defined as a state formed corporation in which substantially all of the activities involve services in the fields of health, law, engineering, accounting, actuarial science, performing arts, or consulting.

For federal tax purposes, the definition of a PC will vary, depending on the tax law that applies. The tax treatment will depend largely on how much of the outstanding stock is owned by employee shareholders. PCs can sometimes choose to be treated as S corporations. For more information, contact an accountant or tax attorney. Like a
C corporation
, a PC is normally treated as a separate tax entity from its owners--the employee shareholders. C corporations may distribute money or property to shareholders. The method used to make a corporate distribution will determine the tax consequences of the withdrawal. Generally, nonliquidating distributions (those that don't dissolve the business) will take the following forms:

- Dividends
- Return of capital
- Wages for services
- Fringe benefits
- Loans
- Rent payments