



THE POWER OF BEING UNDERSTOOD

ENTITY CHOICE REVIEW

Re-evaluate the structure of your pass-through business after tax reform

Tax reform has transformed the playing field for businesses:

- Corporate tax rates have been slashed from 35 percent to 21 percent.
- Pass-through businesses such as S corporations and partnerships may now qualify for a new pass-through deduction that would effectively cut their tax rates from 39.6 percent to 29.6 percent.
- Fundamental international tax reform will have dramatic consequences for those businesses that are internationally active.
- States may choose to conform to some or all of the federal changes or to initiate state-specific reform plans in response to these changes.

Questions generated by tax reform

These changes have left many business owners asking some fairly fundamental questions:

1. Why should I remain an S corporation, effectively paying a 29.6 percent tax rate, if I could get a 21 percent tax rate as a C corporation?
2. Can my partnership convert to C corporation status and enjoy the lower corporate tax rate?
3. Are there issues beyond the annual tax savings that I should be considering?
4. If I ultimately decide to convert to a C corporation, how do I do so? Is there a deadline?
5. What role do the international tax changes play in this decision?
6. Will I need to re-evaluate my state tax posture once states decide how they'll react to federal changes?

7. Do any of these changes have implications for my compensation strategies, particularly if I'm trying to maximize the benefit of the new pass-through deduction?

In most cases, the entity choice decision is analyzed once, at the time of formation, never to be revisited. However, tax reform has taken the old rules and turned them upside down. So it does make sense for pass-through businesses such as S corporations and partnerships to revisit their original analysis in light of these changes to be sure the current structure is still appropriate.

Re-evaluating your tax structure

The entity choice analysis is complex. The annual tax benefit or burden of your tax status is only one piece of the entity choice puzzle; the other pieces can be equally important, but sometimes not as obvious. For example, consider the following questions:

1. If I convert to C corporation status, what are the implications if I sell my business in five years? 10 years? 50 years?
2. Are there steps I should take prior to converting in order to avoid losing some of the benefits associated with my pass-through status?
3. Does one entity type provide flexibility for estate and gift planning purposes that another does not?
4. Are there potential tax costs associated with changing the entity's tax structure?
5. What if the tax landscape changes, and I decide later that I want to revert to my original structure? Can I do that? Are there tax implications?

Taxpayers need to consider these and many other questions when deciding whether a change in status makes sense. By developing a clear and comprehensive understanding of the future expectations for your business and its owners, RSM can help ensure that you're considering all the relevant variables when making this very important decision.

The RSM entity choice review

RSM understands the variables to consider when deciding whether a conversion from pass-through status (S corporation or partnership) to C corporation status may generate tax savings for your business and its owners. We take a holistic approach to the analysis—involving federal tax, international tax, state and local tax, and estate planning resources to ensure that our analysis addresses potential implications in each of these areas. Through this process, we make sure you understand the relevant variables so you can make an informed decision as to whether a change in structure is advantageous. If it is, we can then help guide you through the process of executing that change.

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