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## **ENTITY SELECTION**

### **Legal Protections, Structural Advantages and Inherent Limitations**

#### **FACULTY:**

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**Director, State & Local Tax & Practice Leader, Tax Controversy Services,**  
**CohnReznick, LLP**

**Matthew Taus, CPA,**  
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**Suffolk County Bar Association, New York**

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**Matthew Taus, CPA/PFS, CFP – Wild, Maney & Resnick, LLP**

Graduated Hofstra University in 2008 with a BBA with specialization in Accounting. He began his career with KPMG performing audits of large multinational companies before transitioning to financial and tax planning for a diversified group of mid-size businesses and individuals focusing on advising high wealth business owners, real estate professionals, and families in the areas of trust, estate and gift tax planning, income tax, and international tax matters. Matthew is an active board member of the Estate Planning Council and the National Conference of CPA Practitioners through which he serves on the tax committee and as vice-chair of the NextGen committee. Matthew is also a member of the American Institute of Certified Public Accountants, New York State Society of CPA's, and Financial Planning Association, and regularly speaks and writes on tax matters for organizations and publications.





**Lance Rothenberg, J.D., LL.M.**, is a State and Local Tax Director & the Tax Controversy Services Practice Leader with CohnReznick, LLP (New York / New Jersey) focusing on state and federal tax controversies and disputes as well as multi-state tax planning issues. Lance has broad experience assisting a wide-range of businesses and business owners, from Fortune 100 companies and high net-worth individuals to small and mid-size businesses, facing a variety of federal, state, local, and multi-state tax issues, including sales and use taxes, personal income taxes and residency, payroll taxes, corporate income and franchise taxes, and excise taxes.

Prior to joining CohnReznick, Lance gained significant tax experience working at prominent, international law firms in both Washington, DC and New York, NY. Lance represents clients facing federal and state audits before the IRS and state/city tax departments, with residency audits, with voluntary disclosure matters, with sales/use tax audits, in collection proceedings, and when necessary, he assists with appeals before administrative tribunals. He frequently helps clients with obtaining advisory opinions and letter rulings, in addressing multi-state nexus issues, with tax clearance issues, with bulk sale issues, with responsible person trust fund assessments, and with responding to routine audit notices. He has significant experience defending New York residency audits, advising on pandemic inspired telework and remote worker multistate tax implications for employees and employers, and has broad experience advising clients on sales and use tax matters, including *Wayfair* nexus and marketplace provider issues.

Lance is a frequent author and lecturer on a variety of state and local tax topics. He genuinely enjoys working with his clients and helping solve their tax problems.





# CHOICE OF ENTITY

NEW YORK - OPPORTUNITIES AND CONSIDERATIONS OF THE VARIOUS FORMS OF BUSINESS OWNERSHIP



## TODAY'S PRESENTERS



- Matthew Taus, CPA/PFS, CFP® is the tax partner in charge of trust, estate, and gift tax at Wild, Maney & Resnick, LLP.



- Lance Rothenberg, JD/LLM is a Tax Director & the Tax Controversy Services Practice Leader at CohnReznick, LLP



# CHOICE OF ENTITY CONSIDERATIONS

Variety of Tax and Non-Tax Considerations, including:

- Number and location of owners of the business
- Funding mechanisms
- Contributions made by owners (Cash? Property? Sweat Equity?)
- Will the owners be employees? How are they involved in the business?
- Power - who has voting rights, managerial control, etc.?
- Liability protection
- Federal tax considerations
- New York tax considerations



# COMMON ENTITY STRUCTURES

- Sole Proprietorship
- General Partnership and Limited Liability Partnership (LLP)
- Limited Liability Company (LLC)
- S-Corporation
- C-Corporation





# SOLE PROPRIETORSHIP

- One-person business operation.
- Advantage of being simple, requiring no formal filing to establish (other than possible DBA application and local registrations). In addition, there is no separate tax return filing or requirement to disclose the balance sheet.
- Primary disadvantage of no legal liability protection for the owner. This extends to actions of employees.
  - Poor estate planning vehicle (addressed through the use of a family LP).
  - An investor is generally not willing to invest significant funds.
  - May be missing out on tax savings and audit reduction risk offered by an S-Corporation, especially if the business has employees.
  - Responsible for employer share of payroll tax liabilities, even if business closes.
- Most appropriate when:
  - Client is just starting out and gross receipts are low.
  - Client is unsophisticated and desires simplicity.
  - Liability is deemed to be very low and client's personal assets are minimal.
  - Even with these factors, the Single-Member LLC is generally desirable.





# GENERAL PARTNERSHIP AND LIMITED LIABILITY PARTNERSHIP

- Partners do not receive salary, and instead receive either guaranteed payments (resemble salary) or distributions known as “draws” against partnership earnings.
- Recourse liabilities and qualified non-recourse liabilities of the partnership are attributable to a partner’s at-risk basis (§465). Non-recourse liabilities of the partnership are attributed to the partner’s tax basis only.
- Sale of a partnership interest is generally subject to capital gains treatment with an exception for “hot assets” which receive ordinary income treatment under §751. These assets include unrealized receivables and substantially appreciated inventory (Form 8308).
- Advantages:
  - Generally no gain or loss on the distribution of property to a member or liquidation of a member’s interest to the extent of their basis. For this purpose, property includes cash and marketable securities (§ 731).
  - The contribution of property to the partnership is not a taxable event (§ 721) unless:
    - Appreciated marketable securities are contributed to an investment company (defined under §351) to achieve portfolio diversification (25%/50% tests of §368(a)(2)(F)(ii)), the transaction is treated as a disguised sale or taxable exchange, or the contribution is of services in exchange for a capital interest (REVPROC93-27).
    - Services are rendered in exchange for membership interest (“Sweat Equity”).
    - Contribution results in net debt relief to contributing partner in excess of basis.
  - Unreimbursed business expenses may be deducted by the partner against partnership income.



# GENERAL PARTNERSHIP AND LIMITED LIABILITY PARTNERSHIP

- General partnerships have two major drawbacks in that there is no liability protection for the partners and that each partner has the ability to legally bind the partnership including fraudulent acts of a partner (with exceptions). As such this structure is rarely used in favor of the limited liability partnership which addresses these issues...sort of.
  - LLP statutes may vary significantly from state to state, and some state limit what types of businesses can be an LLP.
  - A LLP protects partners from wrongful acts of other partners, but may not provide the robust liability protection of an LLC.
  - May require the general partnership style of management where by each partner has the ability to be involved in management and affairs of the partnership.
  - An LLC provides maximum flexibility in the areas of company management and liability protection as members are not personally liable for debts of the partnership (LLP may not be as favorable depending on state law).
- BBA Centralized Audit Regime applies unless the partnership elects out. An eligible partnership is eligible to elect out of these audit rules if less than 100 partners and no partners are partnerships, trusts, disregarded entities, foreign entities that would not be treated as a domestic C-Corporation, and people (including estates) who hold an interest in the partnership on behalf of, or other than a partner. (Final Reg. TD 9829)



# GENERAL PARTNERSHIP AND LIMITED LIABILITY PARTNERSHIP

## **New York Taxation of Pass-Through Entities (Partnerships, LLPs, LLCs)**

- New York State:
  - No entity-level tax
  - Filing fee (based on gross income)
  - Generally, taxed under individual income tax
  - Apportionment
    - Three Factor Formula
    - Services – Office where sales negotiated/consummated
    - TPP - Origination
- New York City:
  - Subject to the Unincorporated Business Tax (UBT)
  - Apportionment
    - Single Sales Factor
    - Services – Place of Performance
    - TPP - Destination



# LIMITED LIABILITY COMPANY (LLC)

- Treated as a partnership for federal income tax purposes (IRS Rev. Rul. 88-76) while providing limited liability protection to all members regardless of their involvement in management.
  - Under “check-the-box” regulations may elect corporate tax treatment (may not change again for 60 months).
- Charging order protection
  - Creditors cannot participate in management and force a distribution, however, in New York, a creditor can permanently control the members interest and force liquidation of the company.
  - Protection does not apply to SMLLC’s.
- Most appropriate when:
  - Holding real property
    - Contribution and distribution of real property is a non-taxable event
    - Qualified non-recourse financing
    - § 754 election (§743(b) and §734(b))
    - § 1031 options (“Drop and Swap”)
  - Flexibility Desired
    - Structure of owners varies
    - Disproportionate income, loss, and capital percentages among owners (considering services and funds provided).
    - Special allocation of income and loss subject to *substantial economic effect rules* (§704(b)). This test considers proper income and loss application, liquidations, and deficit restorations attributable to the capital account of a member. The allocation must have substantial effect on the partners. This usually reflects the economic reality of what occurred (as opposed to an allocation for tax benefits, which is prohibited).

# LIMITED LIABILITY COMPANY (LLC)

- Disadvantages:
  - Flexibility equals complexity (Example: LLC agreements, waterfall provisions, draws compared to salary).
  - A single member LLC is a disregarded entity for tax purposes and therefore can not participate in the newly enacted Pass-through Entity Tax program, utilize owner wages for QBID, and may be subject to higher audit risk.
  - Owner does not desire to go public or otherwise be acquired as LLC's are not eligible for tax-free reorganizations (IRC 368).
  - Property contributed by a member with built-in gains/losses will be allocated to that member when sold by the company. This gain may be accelerated if the property is distributed to another member within 7 years (IRC 704(c)) ("Mixing Bowl Rules").



# LIMITED LIABILITY COMPANY (LLC)

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# SALES TAX PERSONAL LIABILITY - PARTNERSHIP/LLC

## **New York Sales Taxation of Partnership and LLC Responsible Persons**

- NY Tax Law 1133 imposes personal liability for payment of entity sales taxes upon certain owners/operators if deemed “responsible persons”
- Partnerships & LLCs - NY Tax Law 1131 imposes “per se” liability on each partner/member
- “Pro-Rata” Relief for Certain LLP and LLC partners/members:
  - TSB-M-11(17)S (2011)
  - Legislative relief codified in 2018
  - TSB-M-20(2)S (2020)
- Relief:
  - Member not responsible for penalties imposed against entity
  - Sales tax liability reduced to member’s pro-rata share (based upon greater of member’s ownership % or distributive share %)
- Eligibility:
  - Demonstrate not under a “duty to act”
  - Document that ownership and % distributive share profits/losses both < 50%





# SALES TAX PERSONAL LIABILITY - PARTNERSHIP/LLC

## New York Sales Taxation of Partnership and LLC Responsible Persons

- TSB-M-20(2)S (2020) requires:
  - Each member/partner submit
    - *Form DTF-8, Application for Relief;*
    - *Form DTF-8-ATT, Attachment (detailed disclosure for each assessment ID); and*
    - *CMS-I-MN, Request for Conciliation Conference*
  - Application must be submitted before liability becomes fixed/final
  - Obligation to cooperate Department and provide information re other responsible persons
- Ineligible for Relief:
  - General partners
  - Partners/member holding 50% or greater ownership interest or % of distributive share of profit/loss
  - Partners/member if under a “duty to act”
- Potentially Ineligible for Relief:
  - Partner/member has other past-due tax liability
  - Partner/member has been convicted of a tax crime



# C-CORPORATIONS

- Advantages:
  - A Corporation may have multiple classes of stock
    - Allows for common and preferred stock which can be transferred by sale, gift or bequest.
  - Few restrictions on type of shareholders and owner eligibility for tax-free fringe benefits
    - Can be owned by any type of entity
    - Fringe benefits available to all shareholder-employees.
  - Taxed at flat rate (currently 21%) (*IRS PUB 542*)
  - Eligible for Tax-Free Reorganization and Qualified Small Business Stock classification (*IRC 1202*).
- Disadvantages:
  - Earnings distributed as dividends causes double taxation
    - Dividends passed through to shareholders are taxed at their level
  - Accumulated earnings tax if dividends are not declared (§ 531)
    - “In addition to other taxes imposed by this chapter, there is hereby imposed for each taxable year on the accumulated taxable income (as defined in section 535) of each corporation described in section 532, an accumulated earnings tax equal to 20 percent of the accumulated taxable income”
  - No preferred tax rate for capital gain transactions and limited carryforward period.



# C-CORPORATIONS

## **New York Taxation of C-Corporations**

- NY Corporate Tax Reform 2015
- Entity level tax
- NYS/C Apportionment:
  - Single Sales Factor
  - Services - Market-Based Sourcing
  - TPP - Destination
- Combined Reporting
- Tax Incentives: e.g., manufacturing (lower rate)



# S-CORPORATIONS

- One of the most popular choices of entity for many reasons but must be elected by all shareholders
  - Election made on IRS Form 2553 and NY Form CT-6
- They are simple to operate
  - No special accounting rules
  - Great for individuals in an operating business
- Income passing through to shareholders retains their character (§ 1366(b))
  - Ordinary income, dividends, interest, capital gains, etc. are passed to shareholders and taxed at the appropriate rates
- Advantages:
  - Reduction of payroll taxes
    - Owners have to be paid a reasonable salary but can also take profits as distributions
    - *“Distributions and other payments by an S Corporation to a corporate officer must be treated as wages to the extent the amounts are reasonable compensation for services rendered to the corporation” (IRS Form 1120S instructions)*
  - No tax on income distributions to the extent of stock and debt basis
    - Distributions must be according to shareholder capital ownership
  - Shareholders have limited liability and are not responsible for the debts or obligations of the corporation.
  - Eligible for tax-free reorganizations.



# S-CORPORATIONS

- Disadvantages:
  - Only Individuals, estates and certain trusts can be shareholders
  - Only one class of stock can be issued (§ 1361(b)(1)(d))
    - Different shares may have different voting rights
  - S corporations may only have 100 Shareholders maximum
    - Members of a family as well as married couples are considered one shareholder (§ 1361(c)(1))
  - Distributions of appreciated property is a taxable event. Such distribution is treated as a sale to the shareholder at fair market value (§311(b))  
A contribution of appreciated property will be a taxable event unless the transferor receives stock and controls the corporation in exchange.
  - Built in Gains Tax may apply after conversion from C Corp for any appreciated property sold within 5 years
    - If appreciated property is sold within 5 years of conversion from an C to and S corporation the pre conversion gain is taxed at maximum corporate rate
  - Subject to passive activity loss rules/At risk rules
    - Shareholder losses limited to basis in the stock
  - Some states and cities do not recognize S-elections, imposing corporate level income taxes.



# S-CORPORATIONS

## New York Taxation of S Corps

- State “S” election required
- New York State:
  - Taxed like C corporations as far as tax computation
  - Pass-through tax paid by owners
  - No entity level tax
  - Apportionment
    - Single Sales Factor
    - Services - Market-Based Sourcing
    - TPP – Destination
  - Shareholder reports pro-rata share of business income on individual return
- New York City:
  - Taxed under the old G.C.T.
  - Entity level tax – NYC does not respect S status
  - Could be missed because no entity-level S corporation tax at state or federal level
  - Apportionment
    - Single Sales Factor
    - Services – Place of Performance
    - TPP - Destination



# PASS-THROUGH ENTITY TAXATION (PTET)

## (New) PTET Taxation

- **Overview/History**

- TCJA enactment created itemized deduction “cap” limiting individual SALT deduction each year to \$10,000 from 2018 – 2025
- SALT deduction limitation significantly affects residents of high tax states (e.g., NY, NJ, MA, CA)
- Businesses (corporations) are still allowed to deduct the full amount of state/local taxes paid at the entity level as an ordinary business expense

- **State Reaction/Federal Response**

- SALT deduction limitation brought about an uproar among states, especially high tax states whose residents were significantly impacted
- In response, to protect resident individuals, many states enacted state level income tax on PTEs
- Historically, PTEs are not subject to income tax, instead their owners are taxed
- By subjecting the PTE to tax, this lowers the income flowing from the entity to the owner
- **IRS Notice 2020-75** essentially provides that PTE taxes are deductible at the entity level for federal purposes



# PASS-THROUGH ENTITY TAXATION (PTET)

## New York State

- Effective Jan 1, 2021
- Elective entity-level tax
- The PTET is an optional tax that partnerships or New York S corporations may annually elect to pay on certain income for tax years beginning on or after January 1, 2021.
- If an eligible partnership or eligible New York S corporation (electing entity) elects to pay the PTET, its partners, members, or shareholders subject to tax under Article 22 (personal income tax) may be eligible for a PTET credit on their New York State income tax returns.

## • **Considerations**

- Who is eligible
- How to elect?
- What is the expected federal benefit?
- Entity and partners/members need to understand how they are impacted by making / not making election
- Ineligible partners/members?
- Cashflow impact to partners/members?
- Planning opportunities (add a member to SMLLC?)
- New NYC PTET
- Many issues still being worked out....



# THANK YOU



Matthew Taus, CPA/PFS, CFP® is the tax partner in charge of trust, estate, and gift tax at Wild, Maney & Resnick, LLP. He performs financial and tax planning for a diversified group of mid-size businesses and individuals focusing on advising high wealth business owners, real estate professionals, and families in the areas of trust, estate and gift tax planning, income tax, and international tax matters.

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It cannot be relied upon for actual tax advice.

Limited time does not allow for a technical analysis of an actual situation.

Please consult your tax advisor or  
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