Morgan Stanley

PRIVATE WEALTH MANAGEMENT

Insights for Entrepreneurs

Part One: Choosing a Business Structure

Working as part of an integrated advisory team, your Morgan Stanley Private Wealth Advisor can help you make well-informed personal wealth management decisions at every stage of your company's development. Our goal is to provide you with the information, insight and resources needed to help you reach your personal and professional goals. We are here to help you answer the key questions that arise at the intersection of your business strategy and your personal wealth management.

How Should I Structure My Startup Business?

The choice of business structure is a critical strategic decision with wide-ranging impacts on the future of your business. These include how your profits will be taxed, the degree of creditor protection you will be afforded and the range of exit strategies that will ultimately be available to you. Below are some of the most common business structures:

- **GENERAL AND LIMITED PARTNERSHIPS.** In general partnerships, the partners control and manage the company. Each general partner assumes unlimited liability for the debts of the partnership and can incur obligations on its behalf. In the case of limited partnerships, there are normally one or more general partners who maintain full oversight over the management of the business. Limited partners do not engage in the daily oversight of the business and cannot incur obligations on behalf of the partnership. Partnerships are a "pass-through" entity and pay no entity level tax on their income, but rather, pass through any profits or losses to their partners.
- **C CORPORATION.** A C Corporation is a separate legal entity that exists apart from you and any other owners of your firm. One of the key benefits of the C Corporation structure is that it provides you with substantial liability protection. C Corporations also have the ability to attract investors through the issuance of stock, and there may be additional benefits afforded by investment in Qualified Small Business Stock (QSBS). As it is not a pass-through entity, however, you and the other owners are subject to taxation twice, once at the corporate level and then again when earnings are distributed to you in the form of dividends.
- **S CORPORATION.** The primary advantage of S Corporations is that they allow income and losses to be passed through to shareholders. Therefore, unlike C Corporations, S Corporations are only subject to one level of federal taxation. Each state has its own rules regarding how S Corporations can be taxed. S Corporations can have multiple shareholders, but not more than one hundred and there are limits on who can own the shares. S Corporations can only be owned by individuals, charities, estates and certain types of trusts. Corporations, partnerships and non-resident aliens are not permitted to own S Corporation stock.
- **LIMITED LIABILITY COMPANIES (LLCS).** LLCs are constructs that combine the elements of Corporations and partnerships. As the name suggests, members of an LLC have limited liability protection. There is also considerable flexibility. You can elect to have your LLC taxed as either a Corporation or as a pass-through entity. As a pass-through entity, LLCs normally pass earnings and losses through to owners in a manner similar to partnerships. As with Corporations, members of LLCs benefit from legal protection while participating fully in the operation of the LLC business.

What Is Qualified Small Business Stock and Do I Qualify?

Qualified Small Business Stock is part of a U.S. government program to incentivize entrepreneurs to start businesses. If your stock qualifies, you could receive a tax break between 50-100% for the first $10 million of gain when you sell the business. If you reinvest the proceeds within 60 days in another qualifying business, the original sale will not be currently taxable, at least to the degree that a qualifying rollover occurs. While the gain will ultimately be subject to taxation upon disposition, the ability to defer taxation for a period of time may provide you with a significant benefit. Speak to your tax advisor to determine whether the shares in your company qualify. A typical scenario might be a company that is structured as a C Corporation, where you received the shares directly from the company when assets were less than $50 million and have held them for five years.

THE INSIGHTS FOR ENTREPRENEURS SERIES COVERS THE FOLLOWING ADDITIONAL TOPICS:

- Early-Stage Trust and Estate Planning
- Overview of Wealth Planning Structures
- The Public Sale of Privately Held Businesses
- Family-Owned Business Succession Strategies
- Philanthropic Strategies and Structures
- Understanding Equity Compensation

FOR FURTHER INFORMATION

If you wish to discuss which corporate structure is best-suited to your business goals, please speak to your Private Wealth Advisor. He or she can schedule a meeting with a Morgan Stanley Tax, Trust and Estate specialist.

CRC 3341064 12/20 PWM9002481
CS 9946185 12/20