

Basic Business Entities FAQ

1. Can a sole proprietor merge into an LLC?
 - a. **A sole proprietor may choose to become an LLC by filing articles of incorporation with the Secretary of State. After that filing, the entity would be considered a single member LLC (SMLLC).**

2. What are the advantages to a partnership electing to be organized as a corporation?
 - a. **A partnership may elect to be taxed as a corporation to potentially take advantage of a lower corporate tax rate. For example, \$100,000 of corporate income in the State of Kentucky will amount to a tax liability of \$4,500. \$100,000 of individual (personal) income would amount to a tax liability of approximately \$5,663. Another benefit would be that each partner in a general partnership is both jointly and severally liable for the liabilities of the general partnership, whereas a shareholder in a corporation is only liable up to the amount of their investment or any loans they may have personally guaranteed.**

3. What type of entity are home owner's associations considered and what are their filing requirements?
 - a. **Typically, a home owner's association will be formed as a nonprofit organization under IRC provision 501 c (4). However, if the association is for profit, it may file federal form 1120-H to take advantage of certain tax benefits afforded to such an association.**

4. What are the tax and dissolution implications of a partner who brings no monetary investment to a partnership?
 - a. **All such scenarios can (and should) be included in the formal partnership agreement drafted at the outset of the partnership. Absent that agreement, the implications may be decided in court.**

5. Why does Kentucky allow people who are associated with a business that has an outstanding tax debt with Kentucky to register a new business with Kentucky?
 - a. **There is no restriction currently written in the Kentucky Revised Statutes to prevent this from occurring. Such a provision would require legislation.**

6. Is it possible for an S Corp to become a C Corp?
 - a. **An S Corporation election may be revoked (subsequently returning the corporation back to C Corporation status,) with the consent of the shareholders. Consent would occur if shareholders holding more than 50% of the outstanding shares of stock (voting or nonvoting,) decide to revoke the S Corporation status. Also, an S Corporation may create a situation that bars it from being an S Corporation (i.e. transferring a share of stock to a C Corporation.)**

7. What is PLLC?
 - a. **A PLLC is a Professional Limited Liability Company that is organized for the purpose of providing professional services. Usually, professions in which the state requires a license to provide services (doctors, lawyers, architects, etc.) require the formation of a PLLC.**

8. What is the tax treatment of a foreign corporation?
 - a. **A foreign corporation is defined as one that is domiciled outside of Kentucky. Should a foreign corporation have Kentucky income, it would be taxed the same as a domestic corporation.**

9. How can a C Corporation become a pass-through entity?
 - a. **All corporations that are formed in Kentucky are C Corporations by default. However, a C Corporation may elect to become a pass-through entity by becoming an S Corporation if they meet the following qualifications:**
 - i. **Be a domestic corporation**
 - ii. **Have only allowable shareholders**
 - iii. **including individuals, certain trust, and estates and**
 - iv. **may not include partnerships, corporations or non-resident alien shareholders**
 - v. **Have no more than 100 shareholders**
 - vi. **Have one class of stock**
 - vii. **Not be an ineligible corporation i.e. certain financial institutions, insurance companies, and domestic international sales corporations.**

10. How do the terms in a legally binding partnership agreement affect tax liabilities/outstanding tax debt with the Kentucky Department of Revenue?
 - a. **In a partnership, all partners are jointly and severally liable for the taxes owed by the partnership. That means the Kentucky Department of Revenue will collect on taxes owed by a partnership by collecting from any and all**

partners, superseding the terms in a partnership agreement.

11. Is there such a thing as a QREIT?
 - a. **Yes; a QREIT is a Qualified Real Estate Investment Trust; if it is a wholly owned subsidiary of a Real Estate Investment Trust, it is treated as a disregarded entity for tax purposes.**

12. How is a disregarded entity treated for tax purposes?
 - a. **Only a single-member LLC can be considered a disregarded entity. A disregarded entity is not considered separate from its owner for tax purposes. That means any tax liability the entity has will pass through to the individual member who will then reported it on his/her individual income tax (Form 1040, Schedule C.) For Kentucky, the income will be included on the Form 740 in the Federal Adjusted Gross Income brought over from the Form 1040.**

13. Why are a husband and wife allowed to file as a sole proprietor?
 - a. **Generally, if a person and their spouse jointly own and operate an unincorporated business and share in the profits and losses, they are partners in a partnership (whether or not they have a formal partnership agreement.) A husband and wife should not file a Schedule C or C-EZ; they should file a 1065.**

14. Is it possible for a person to have ownership of several different types of entities and still be an owner of an S Corporation? Can other entities be owners in an S Corporation?
 - a. **These scenarios are possible provided that the owners of the S Corporations are not a C Corporation or a partnership.**

15. When dissolving a business with the Kentucky Department of Revenue, is it possible to make the date of dissolution retroactive? In other words, if a person's business is practically over in 2007, but they dissolve it with Kentucky in 2009, is it possible for that person to dissolve based on their 2007 information?
 - a. **No. Until an entity properly dissolves, they are considered to be in business and are responsible for filing returns.**

16. What legal recourse does a partner have if the partnership's tax liability is not being equally/fairly collected amongst all of the partners?
- a. **As above, this matter should be decided in a partnership agreement and, absent that, a court may have to decide.**
17. Can a naturalized citizen of the United States be a shareholder of an S Corporation?
- a. **Yes, a naturalized citizen of the United States does meet the citizenship requirements for being a qualified shareholder of an S Corporation.**
18. Can a Kentucky corporation register in another state?
- a. **Yes. A Kentucky corporation should register in another state if it has business activity or meets the nexus requirements of that state.**