

The Advantages and Disadvantages of Forming a Florida Limited Liability Company (LLC) Versus a Florida Corporation

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This Note outlines advantages and disadvantages of forming a new business entity as a Florida limited liability company (LLC) versus a Florida corporation, and of electing S corporation status of that entity for income tax purposes.

Florida Law Governing Corporations and LLCs

Founders intending to organize a business entity under Florida law limiting exposure of their assets to its creditors can choose among a number of entity types, not all suitable for all businesses. Common types and their governing Florida statutes are:

- *Corporation* -- Business Corporation Act [F.S. Ch. 607].
- *Limited Liability Company (LLC)* -- features of both corporations and partnerships -- Revised Limited Liability Company Act [F.S. Ch. 605].
- *Professional corporation or LLC* -- Professional Service Corporation and Limited Liability Company Act [F.S. Ch. 621], taking precedence over F.S. Ch. 607 or 605.
- *Corporation and LLC classified as corporation for federal income tax purposes* – Income Tax Code [F.S. Ch. 220].

F.S. Ch. 605 replaced Florida Limited Liability Company Act, F.S. Ch. 608, as of January 1, 2014. A committee of the Business Law Section, The Florida Bar is drafting a plenary revision of F.S. Ch. 607 (including standards of care, conflicts of interest transactions and indemnification statutes), last completely revised in 1990.
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Taxation

Corporation net income generally is “double taxed” federally, as taxable income of the corporation and, to the extent of distributions (dividends) to its owners (shareholders), taxable income of each shareholder. Florida taxes net income of a corporation doing business, earning income or existing in Florida, including owning interests in any Florida entity. Florida does not tax income of individuals, partnerships or LLCs not electing income taxation like that of a corporation (corporate taxation). Unless an LLC elects corporate taxation, its net income is taxed federally and by Florida only as taxable income of its owners (members), regardless whether distributed to them. See [box](#) for examples.

- Net income of a Florida corporation having as shareholders only individuals maintaining primary legal residence in Florida is subject to federal “double taxation” and Florida taxation of the corporation only.
- Net income of a Florida corporation or Florida LLC electing corporate taxation, in each case having a corporation (Florida or foreign) shareholder, is “double taxed” federally and by Florida.
- Net income of a corporation (Florida or foreign) shareholder of a Florida LLC not electing corporate taxation (regardless whether single or multiple member) is taxed federally and by Florida.
- Net income of a Florida LLC not electing corporate taxation and having as one or more members only individuals maintaining primary legal residence in Florida is subject only to federal taxation of each member, not federal “double taxation” or any Florida income tax.

An LLC is an entity separate from its member or members for federal employment (FICA) and excise taxes purposes, however. Unless the LLC elects corporate taxation and agrees in writing with each member for services to the LLC’s clients at reasonable compensation to that member, all net income of the LLC up to the maximum prescribed by regulation is subject to 15.3% FICA tax.

If eligible, a corporation or an LLC electing corporate taxation (among other reasons, in order to limit FICA tax) can elect status as an *S corporation* status, which, like an LLC not electing corporate taxation, passes its entire income, losses, deductions and credits to its owners for federal and Florida income tax purposes. Those owners report the flow through items on their respective tax returns. See [S corporation Election](#).

LLC’s are ineligible for tax-free reorganizations (*e.g.*, stock for stock exchanges, not asset sales) and are unattractive to offshore investors seeking to avoid U.S.A. income taxation by restricting distributions.

LLC distribution of appreciated property generally is tax free; the members have a carryover basis in that property. Distributions by a corporation of its appreciated property results in taxable income and a stepped up basis in that property for the shareholders.

If an entity owns real estate subject to substantial debt, an LLC member’s tax basis can be adjusted for LLC liabilities on sale of the member’s interests; members potentially can deduct more LLC tax losses than shareholders of a corporation can.

Common Features of Florida Corporations and LLCs

- Limited exposure of owners’ assets not invested in the entity to its creditors unless its “veil” is “pierced” for fraud, improper or misleading conduct, inadequate capital or income or its owner’s commingling assets or controlling the entity as an *alter ego*. But

an officer, agent, member, manager or employee of an entity organized under F.S. Ch. 621, and the entity itself, is liable for negligent or wrongful acts or misconduct committed by that person or another person under the direct supervision and control of that person while rendering professional service on behalf of that entity.

- Organized by filing with the Florida Department of State (DOS) Articles of Incorporation or Organization and designating a registered office and agent.
- One or more owners of any types.
- Power to differentiate voting, distribution and liquidation rights and preferences among owners by classes or series of ownership interests.
- Management either by owners or designated persons (directors; officers; managers) or others under delegated authority.
- Similar criteria for protecting directors, managing members and managers from personal liability for damages.
- Restriction of right to transfer ownership interests by documents filed with DOS or agreements among owners.
- Right of entity or its owners to purchase interest of member commencing action for judicial dissolution.
- Acquisition of entity by merger, consolidation, sale of substantially all assets or share exchange.
- Requirement to maintain records of owners, directors or managers, agreements among owners, filings with DOS, and 3 fiscal year financial statements.

Advantages of Florida LLCs Versus Florida Corporations

- Only if:
 - LLC has at least 2 members, regardless of percentage membership interests; or
 - LLC has 1 member and (i) the creditor of the member or member's transferee is not a judgment creditor or (ii) if a judgment creditor, it fails to establish to the court that distributions under a charging order will not satisfy its judgment within a "reasonable time,"

the rights of a member's or transferee's creditor is limited to a "charging order" against that member's or transferee's transferable interest in the LLC requiring payment to that creditor of any distribution otherwise payable to that member or transferee (subject to exceptions): That creditor cannot sell that interest in foreclosure or vote that member's

voting rights without the consent of each other member (*e.g.*, vote for LLC dissolution in order to obtain direct ownership of LLC assets). This protection may counter “reverse piercing” or “outside reverse piercing” of the corporate “veil” recognized by Florida courts.

Predecessor of F.S. Ch. 605.0503 was amended in response to the Florida Supreme Court opinion in Olmstead v. Federal Trade Commission, 44 So. 3rd 76 (2010).

- Issuance of additional membership interests without amendment filed with DOS to increase “authorized shares.”
- No required bylaws, officers (corporations must have at least one officer to prepare minutes and authenticate records), meetings of members, managing members or managers, or minutes of meetings. Failure of an LLC to observe formalities alone does not justify “piercing” its “veil.”
- Clearer statutes regarding management conflicts of interest, required fairness, standards of care (modifiable by operating agreement) and indemnification.
- Flexibility to give non-members, *e.g.* lenders, veto powers over operating agreement amendments.
- Flexibility to limit apparent authority of members or managers by filing a statement of authority with DOS.
- Flexibility to base LLC distributions and allocations of profits, depreciation and losses on values of members’ capital contributions (without reduction for return of capital) instead of percentage LLC membership interests or proportion of corporation shares.
- Flexibility to alter or eliminate the duty of loyalty and alter the duty of care of managers and managing members prescribed by statute, to the extent permitted by statute, by the agreement among owners.
- Lower filing fees to DOS for LLC annual report (\$138.75) and certificate of status (\$5.00) than for corporation annual report (\$150.00) and certificate of status (\$8.75).
- Potentially lower tax on net income. See [Taxation](#).

Disadvantages of Florida LLCs Versus Florida Corporations

- Permitted dissociation of a member (*e.g.*, withdrawal of member, death of individual member, and, in a member-managed LLC, bankruptcy of a member); ownership by that member of transferable interest in the LLC as transferee.
- No perpetual existence of the LLC: LLC dissolution (even if fewer than a majority of its members consent and no other circumstance that its operating agreement states causes

dissolution) upon 90th consecutive day with no member unless transferees owning rights to receive a majority of distributions consent to admit at least 1 specified person that becomes a member.

- LLC may advance reasonable expenses to, and indemnify, only its former or present member or manager. Indemnification is not mandatory even if indemnitee successfully defends a proceeding.
- Because of no perpetual existence, flexibility to modify statutory requirements by the articles of organization or operating agreement, ease of dilution of percentage ownership by issuance of membership interests, novelty compared with corporations, and less judicial precedent than for corporations (*e.g.*, management standards of care, conflicts of interest), LLC is less acceptable to venture capitalists and hedge funds (see [Taxation](#)) and less suitable for public offerings of securities or employee securities benefit plans except in certain industries (*e.g.*, energy).
- No incentive stock options; instead, grants to employees of LLC profits interests that may be deemed to constitute partnership interests for tax and employee benefit purposes.
- Requirement to maintain 3 fiscal year tax returns and records stating the amount of cash and property or other benefits contributed and agreed to be contributed by each member.
- Higher filing fees to DOS to form an LLC (\$125.00) than to incorporate a corporation (\$78.75). Generally higher cost for certified copy of LLC record (\$30.00 fixed fee) than for certified copy of corporation record (small per page fee up to \$52.50 maximum for in person requests; \$8.75 fixed fee for mail-in requests).
- Cannot participate in federal tax-free reorganizations. Potentially higher federal FICA and excise taxes. See [Taxation](#).

S corporation Election

Advantages

- Generally, no federal or Florida “double taxation” of S corporation net income.
- Potential limitation of amount of LLC net income otherwise subject to FICA tax.

Disadvantages

- 1 to 100 owners; inappropriate for public offerings of securities.
- No non-resident alien individual, nor partnership, LLC, or corporation owner unless S corporation is a “qualified S corporation subsidiary” of another S corporation. Estates and certain trusts and exempt organizations may be owners.

- No classes of owners distinguishable by rights to distributions from the entity (classes distinguishable only by voting rights, or constituting debt instruments, options or warrants, may be permitted).
- Some corporations are ineligible (certain financial institutions, insurance companies and domestic international sales corporations).
- Must pay salary to certain owners and have passive income complying with regulations.

Recommendation

A Florida LLC having at least 2 members (even if the percentage membership interest of all but one member is negligible) generally is best for most Florida businesses (i) having few owners or owners not eligible to be shareholders of an S corporation (See [S corporation Election: Disadvantages](#)), (ii) having assets desirable for protection against members' creditors, and (iii) not anticipating becoming or acquiring a company with publicly traded securities, adopting an employee securities option plan or being sold in a tax-free reorganization.

The LLC may limit the amount of its income subject to FICA tax by electing corporate taxation and entering into an employment agreements with members for services in exchange for reasonable compensation, and also, if eligible, may elect S corporation status to limit federal "double taxation" and reduce or eliminate Florida tax on that net income.