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SHOULD YOUR LLC ELECT TO BE TAXED AS A DISREGARDED ENTITY?

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As you know, you can choose to do business as a sole proprietorship, partnership, corporation, or LLC. An LLC (Limited Liability Company) is so flexible that you can **choose** to file income tax returns as a corporation, partnership, or disregarded. Interesting? Let's explore **LLCs filing as disregarded entities**.

The term "**disregarded**" means that the LLC is ignored for federal income taxation. You simply choose not to file any federal income tax returns. Instead, you report transactions in your personal income tax.

Most LLCs with multi members file as partnerships. As such, they have to maintain journals for rents collected, expenses paid, and general ledgers to keep track of all assets, liabilities, capital, revenues, and expenses. They also have to file federal and state partnership returns. All of these chores are additional burdens to apartment owners who already face headaches from tenants, inspectors, and agencies.

Do you really have to comply with all of these administrative duties? **No. You don't have to account for all assets and liabilities** other than land, building, improvements, and loans. **You don't have to file partnership returns** other than a state form for an LLC tax. Therefore, you **simplify your record keeping tasks, reduce administrative burdens, and save tax preparation fees**. You do so by "checking the box" (meaning choosing to be taxed) as a **disregarded** entity. You would, as a disregarded entity, merely report LLC activities in your **personal** Schedule E for rental transactions.

Let's assume that you and your spouse operate a rental building inside a multi-member LLC. Let's also assume that you are the only members and that you have been filing partnership tax returns for the entity.

Accounting and tax attributes of your current filing as partnership:

1. Your LLC previously chose to be taxed as a partnership.
2. It files federal and state partnership information tax return forms 1065 and 565.
3. It also files a state Form 568 to compute its California annual fee.
4. It's required to maintain journals and ledgers to keep track of revenues and expenses.
5. It's also required to maintain books for all assets and liabilities.

Accounting and tax attributes if you change to disregarded entity:

6. You **don't** have to file federal and state partnership tax returns 1065 and 565.
7. You **don't** have to account for *all* assets & liabilities.
8. You'd **save** some accounting fees and tax preparation fees.
9. You'd merely report your rental operations in Schedule E of your **personal** Income Tax.
10. All that is left is California annual Form 568. ☺

Caution: A multi-member LLC cannot elect to be disregarded for federal income tax.

Good news 1: An LLC that owns a residence, with a single owner that is disregarded for federal tax purposes, is treated as owning the residence; therefore, it is eligible for Code section 121 **exclusion of \$250/500K gain from the sale of your principal residence**.

Good news 2: Despite all the simplification, your entity **remains as an LLC**.