Entity & Tax Classification: Which Route?

A 2026 decision guide for new business owners & franchise buyers. Answer in order — the first "yes" decides.

2026 EDITION

First, the false choice: an LLC is how your business is set up with the state; S-corp and C-corp are how it's taxed by the IRS (Form 2553 or 8832). The same LLC can be taxed four different ways — so what you're really choosing below is a tax treatment and a way to fund it.

1 Financing with retirement funds via a ROBS rollover?
Uses an old 401(k) or IRA to fund the business instead of borrowing. Needs about $50,000+.

YES → **C CORPORATION — REQUIRED, NO EXCEPTIONS**
Only a C-corp can issue stock a retirement plan is allowed to buy. Budget ~$5K to set up and ~$1.5–1.9K a year for filings and a stock appraisal. Unwind it before any S election.

NO ↓

2 Will any owner live outside the U.S., will another company own part of it, or will there be more than 100 owners?

YES → **S-CORP IS OUT**
S-corps allow only 100 or fewer U.S. individual owners — one owner outside those rules cancels it. Use a C-corp (anyone can own it) or an LLC taxed as a partnership.

NO ↓

3 Raising outside investors — preferred equity, convertibles, or a second class of stock?
Different voting rights are fine — different payouts aren't.

YES → **S-CORP IS OUT — ONE-CLASS RULE** ASK REEDER
An S-corp gets one class of stock, so no preferred deals for investors. Use a C-corp for outside money, or a partnership for custom profit splits.

NO ↓

4 Is the primary asset rental real estate?

YES → **LLC / PARTNERSHIP — NEVER A CORPORATION**
Pulling appreciated property out of a corporation triggers tax, and you lose deductions partnerships allow.

NO ↓

5 Retaining most profits for growth, want tax-free fringe benefits, or planning a big stock-sale exit?

YES → **MODEL THE C-CORP** ASK REEDER
Profit left in the company is taxed once at 21%, versus about 39.8% at the top once you take it out. QSBS can exempt 50/75/100% of the gain on stock held 3/4/5 years, up to $15M. Owner benefits are tax-free.

NO ↓

6 Expected net profit — after paying yourself a reasonable salary?
This is the 15.3% self-employment tax question — it applies to the first $184,500 of pay in 2026.

→ **UNDER ~$50–80K → STAY DEFAULT**
Stay a sole proprietor, single-member LLC, or partnership. Payroll and a second tax return would cost more than you'd save. The 20% deduction still applies.

→ **OVER ~$50–80K & STABLE → ELECT S-CORP**
File Form 2553 by March 15. Pay yourself a fair salary; profit above it escapes the 15.3% tax. Document how you set that salary — the IRS checks it first.

EVERY ROUTE Your state adds rules — **CA** charges S-corps 1.5% + $800 minimum · **NYC** ignores S status · **NY and NJ** need their own forms. Ask about a state **PTET election**, and if you may sell soon, plan before you file.

The Cheat Sheet

HARD RULES — NO EXCEPTIONS

ROBS financing → **C-corp, mandatory**

Foreign or entity owner → **No S-corp**

Preferred / 2+ stock classes → **No S-corp**

Rental real estate → **Never a corporation**

S-CORP BREAK-EVEN

$50K–$80K

net profit where the S election starts paying for itself

Savings ≈ 15.3% × profit taken as distributions, minus payroll service, 1120-S prep & state minimums (~$2–5K/yr all-in). Typical savings once it works: **$15–30K/yr**. Salary must be defensible market comp — the “60/40 rule” is a myth (see *Watson*, 8th Cir. 2012).

ROBS IN FIVE STEPS

1. Form a new C-corporation
2. The C-corp adopts a 401(k) that permits employer stock
3. Roll prior 401(k)/IRA funds into the new plan, tax-free
4. The plan buys the corporation's stock at appraised value
5. The corporation funds the business — debt-free, retirement at risk

WHEN TO CALL REEDER

- Setting your exact reasonable-compensation figure (and documenting it)
- Your S-corp break-even once state tax, QBI & PTET are layered in
- C-corp vs pass-through when you'll both retain and distribute
- Multi-unit franchise structures, investor terms, or unwinding a ROBS

COMPARE AT A GLANCE

	LLC (default)	S-corp	C-corp
Federal tax	Pass-through (Sch. C / 1065)	Pass-through (1120-S)	21% flat + tax on dividends
SE / FICA	15.3% on all net earnings	Only on W-2 salary	Only on W-2 salary
QBI 20%	Yes	Yes	No
Owners	Anyone	≤100; U.S. individuals & certain trusts	Anyone — incl. 401(k) plan (ROBS)
Equity	Flexible allocations	One class of stock only	Preferred, multiple classes, QSBS
Best for	Starting out; real estate	Stable profit above ~$50–80K	ROBS, investors, retained growth, QSBS exit

SIX MYTHS, BUSTED

“Always form an S-corp.” Below break-even it costs more than it saves.

“LLC vs. S-corp.” Not rivals — an LLC can elect S-corp taxation.

“ROBS is free money.” Your retirement is at risk, plus ongoing compliance.

“ROBS works with an LLC.” Only a C-corp can issue plan-qualifying stock.

“My LLC protects me from everything.” Franchisor & lender personal guarantees pierce it.

“Put the rental in an S-corp.” Basis & step-up problems make this a costly mistake.

STATE WATCH-LIST

CA	1.5% entity tax on S-corps + $800 annual minimum; PTET due June 15
NYC	Doesn't recognize S status — General Corporation Tax applies
NY	Separate state S election required (Form CT-6)
NJ	Separate state election required (Form CBT-2553)
TX	No income tax, but franchise/margin tax hits all entities
PTET	36+ states let the entity deduct state tax past the $40,400 SALT cap

FORMS & DEADLINES

Form 2553 S election — Mar 15 (or ~75 days from formation; late relief per Rev. Proc. 2013-30) · **Form 8832** entity classification (60-month lock after a change) · **Form 5500** annual ROBS plan filing · **CT-6 / CBT-2553** separate NY / NJ S elections

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