CHECKLIST

- ☐ If forming an entity (i.e. other than a sole proprietorship or general partnership), your first step is to have your legal advisor prepare the appropriate documents to be filed with the Tennessee Secretary of State.

- ☐ After the entity has been formed, a copy of the stamped organizational documents should be filed with the Register of Deeds office in each Tennessee County in which your company will conduct business.

- ☐ Obtain a federal identification number for your entity by filing IRS Form SS-4 or online at www.irs.gov.

- ☐ If you will be subject to Tennessee Alcoholic Beverage Tax, Sales and Use Tax, Severance Taxes, Solid Waste Taxes, Tobacco Tax, or Wine Direct Shipper Tax, you should complete a Tennessee Department of Revenue Application for Registration.

- ☐ If you will be subject to Tennessee Franchise and Excise Taxes, but none of the other taxes listed in the preceding checklist item, then you should complete the Tennessee Department of Revenue Application for Franchise, Excise Tax Registration within 15 days after forming your entity with the Tennessee Secretary of State.

- ☐ If your entity qualifies for exemption from the Tennessee Franchise, Excise Taxes, then you should complete the Application for Exemption, Franchise and Excise Taxes. (Note: You will need to complete the Application for Franchise, Excise Tax Registration in addition to the Application for Exemption.)

- ☐ You should obtain a business license from the County Clerk's office in which your business is based, unless your company is specifically exempt from obtaining a business license.

- ☐ You should obtain a business license from each city in which you expect to have $50,000 or more in sales during the filing period for your business classification (business tax is based upon filing periods that may differ from your federal income tax filing period), unless your company is specifically exempt from obtaining a business license.

- ☐ Most banks require you to provide the following documents to open a bank account for a legal entity (other than a sole proprietorship): (1) copy of organizational documents after being stamped by the Tennessee Secretary of State and your county's Register of Deeds, (2) federal identification number, and (3) copy of business license(s). In the case of a sole proprietorship, banks may only require a copy of your business license.

- ☐ If your business will have employees, including shareholder-employees of corporations, you will need to obtain a Tennessee employer number and Tennessee unemployment tax rate. You should complete the Tennessee Department of Labor and Workforce Development Report to Determine Status/Application for Employer Number.

Comparison of Business Entities

NOTE: THESE COMPARISONS DO NOT CONSIDER STATE TAX IMPLICATIONS.

Applicable Factor	C Corporation	S Corporation	Sole Proprietor	Partnership/Limited Liability Partnership	Limited Liability Company
I. Formation					
A. Method	Articles of Incorporation	Articles of Incorporation	None	Partnership agreement	Articles of Organization filed in state recognizing LLCs
B. Owner eligibility					
1. Number of Owners	No limit	100 (Note family members considered as one)	One	Two or more for general partnership; one or more general and one or more limited for limited partnership	No limit
2. Type of Owners	No limitation	Certain individuals, estates, charities, ESOP, trusts and S corporations	Individual	No limitation	No limitation
3. Affiliate Limits	No limitation	Can own up to 100% of the stock of a C corporation and own 100% of the stock of a qualified sub-s subsidiary. No limitation	No limitation	No limitation	No limitation
C. Capital Structure					
1. Equity	No limitations (multiple classes permitted)	Only one class of stock	No stock	No limitations (multiple classes)	No limitations
2. Debt	No specific limits on debts/equity ratio	Safe-harbor for debt	No specific limits	No specific limits	No specific limits
D. Status Determination					
1. Election by Entity	No election requirements	Required election	No election requirements	No election requirement but state law filing	None, unless corporate status is elected
2. Owner Consents	None required	Consent required	None required	None required	None required
E. Liability (check applicable state laws)	Limited to shareholder's capital contributions	Limited to shareholder's contribution	Unlimited	General partners jointly and severally liable. Limited partners are generally limited to capital contributions.	Limited to member's capital contributions.

Comparison of Business Entities

Applicable Factor	C Corporation	S Corporation	Sole Proprietor	Partnership/Limited Liability Partnership	Limited Liability Company
II. Operational Phase					
A. Tax Year	Any year permitted (limit for personal service corporation)	Generally calendar year	Generally calendar year	Generally calendar year	Generally calendar year
B. Tax on Income	Corporate level	Owner level except QSST, where paid by beneficiary.	Individual level	Owner level	Member or entity if elected
C. Elections	Corporate level	Corporate level	Individual level	Partnership level	Entity level
D. Allocation of Income/Deductions	Not permitted (except through multiple equity structure)	Not permitted (except through debt/equity structure)	N/A	Permitted if substantial economic effect	Permitted if substantial economic effect
E. Character of Income/Deductions	No flow-through to shareholders	Flow-through to shareholders	Flow-through to individual	Flow-through to partners	Flow-through to members
F. Net Operating Losses	No flow-through to shareholders	Flow-through to shareholders (limited to basis)	Flow-through to individual	Flow-through to partners (limited to basis)	Flow-through to members (limited to basis)
G. Net Capital Losses	No flow-through, but five year carryforward	Flow-through to shareholders	Flow-through to individual	Flow-through to partners	Flow-through to members
H. Effect of Statutory Limitations	Imposed at corporate level	Imposed at shareholder level	Imposed at individual level	Imposed at partner level	Imposed at member level
III. Owner Compensation Arrangements					
A. Fringe Benefits	Shareholder-officers qualify for benefits	Shareholder officers qualify for benefits (medical premiums for greater than 2% shareholders treated like partnership guaranteed payments)	Generally subject to limits applicable to individuals	Limited participation for partners	Limited participation for members
B. Retirement Benefits	Shareholder-officers included in qualified plans	Certain limits on shareholder-officers	Generally subject to limits applicable to individuals	Certain limits applicable to partners	Certain limits applicable to members
C. Reasonable Compensation Limits	Applicable to shareholder-officers	Applicable to shareholder-officers	N/A	Applicable where capital is a material factor	Applicable where capital is a material factor
D. Payroll Taxes	Shareholder-officers subject to payroll taxes only on compensation	Shareholder-officers subject to payroll taxes only on compensation	Active owner subject to SE taxes on all income. No SUTA or FUTA.	Active general partner subject to SE taxes on all income. No SUTA or FUTA.	Active member subject to SE taxes on all income. No SUTA for FUTA.

Comparison of Business Entities

Applicable Factor	C Corporation	S Corporation	Sole Proprietor	Partnership/Limited Liability Partnership	Limited Liability Company
IV. Transactions with Owners					
A. Distributions of Cash	Dividends to extent of earnings and profits	Dividends, generally no effect until the accumulated adjustment account (AAA) fully recovered (beware transition rules for former C corps)	No effect	No effect except in calculation of basis	No effect except in calculation of basis
B. Distribution of Property	Dividend treatment; gain recognition to entity	Gain recognition to entity	No effect	No gain or loss to entity	No gain or loss to entity
C. Purchase of Owner's Interest					
1. Partial Interest	Probable dividend treatment	Tax-free, but gain for proceeds in excess of basis	Treated as sale of each asset	Capital gain treatment, except ordinary income for ordinary income assets.	Capital gain treatment, except ordinary income for ordinary income assets.
2. Entire Interest	Capital gain treatment with exceptions	Capital gain treatment after basis recovered	Cannot sell entity interest; sale of business is viewed as a sale of each asset	Capital gain treatment, except ordinary income for ordinary income assets and certain §736 payments	Capital gain treatment, except ordinary income for ordinary income assets and certain §736 payments
D. Property Sales to Entity by Owner	Possible dividend treatment or contributions to capital	Any excess value treated as distribution or contribution	N/A	Any excess value treated as distribution or contribution	Any excess value treated as distribution or contribution
E. Property Sales to Owner by Entity	Possible dividend treatment or contributions to capital	Any excess value treated as distribution or contribution	N/A	Any excess value treated as distribution or contribution	Any excess value treated as distribution or contribution
V. Termination of Entity or Owner Interest					
A. Sale of Interest by Owner to Third Person	Capital gain; no effect on basis of corporation's assets (note exception § 338)	Capital gain; no effect on basis of corporation's assets (note exception § 338)	Cannot sell entity interest; sale of business is viewed as a sale of each asset	Capital gain subject to § 751 ordinary income categorization	Capital gain subject to § 751 ordinary income categorization
B. Death of Owner	Estate continues as shareholder; FMV at date of death is basis for shares; no effect on basis of corporation's assets	Estate continues as shareholder; FMV at date of death is basis for shares; no effect on basis of corporation's assets	Estate takes over business	Estate as partner subject to agreement, FMV at date of death basis for interest	Estate as member subject to agreement, FMV at date of death is basis for interest

Comparison of Business Entities

Applicable Factor	C Corporation	S Corporation	Sole Proprietor	Partnership/Limited Liability Partnership	Limited Liability Company
C. Liquidation Distributions					
1. Effect to Distributor	Gain recognition if appreciated property distributed	Gain recognition if appreciated property distributed	N/A	No gain recognition on asset distributions	No gain recognition on asset distributions
2. Effect to Recipient	Capital gain on excess value received over basis	Capital gain on excess value received over basis	N/A	Substituted basis in assets equal to basis in partnership interest	Substituted basis in assets equal to basis in LLC interest
D.Reorganization	Tax-free to shareholders if qualifying under reorganization provisions (§ 354 and § 368)	Tax-free to shareholders if qualifying under reorganization provisions (§ 354 and § 368)	N/A	No taxability on merger of partnerships	No taxability on merger of LLC
E. Carryover of Tax Attributes	Carryover of tax attributes to successor entity if tax-free reorganization	Carryover of tax attributes to successor entity if tax-free reorganization	N/A	N/A	N/A

ENTITY TYPES AND FURTHER DISCUSSION

In our experience with small businesses, the majority of those Tennessee-based small businesses who desire some degree of limited liability for the owners select either (a) a Tennessee corporation that elects Subchapter S status with the Internal Revenue Service or (B) a Tennessee limited liability company. The four pages immediately preceding this page include a comparison of all for-profit entity types. Following is a general synopsis, from an organizational, income tax, and limited liability perspective, of each entity type:

1. Sole Proprietorship   A sole proprietorship is not required to file organizational documents with the Tennessee Secretary of State. An annual report and related fee are not required to be filed with the Tennessee Secretary of State. A sole proprietorship provides no liability protection for the owner. A sole proprietorship is required to report its income and deductions to the Internal Revenue Service on Schedule C which is an attachment to the owner's individual income tax return (Form 1040). All federal income taxes on the sole proprietorship are imposed at the individual owner's level. A sole proprietorship only has one owner.

2. General Partnership   A general partnership ("GP") is not required to file organizational documents with the Tennessee Secretary of State. An annual report and related fee are not required to be filed with the Tennessee Secretary of State. A GP provides no liability protection, and all partners may be held personally liable for the actions of another partner as those actions relate to the GP. Partners in a general partnership should consider having an attorney prepare a partnership agreement to accurately document the partnership's "rules". A GP is required to file an annual partnership income tax return with the Internal Revenue Service (Form 1065). All federal income taxes on the GP are imposed at the individual partners' level and thus the GP pays no federal income tax at the partnership level. A GP must have two or more partners. A proper reorganization of a GP into another type of entity generally has minimal tax implications.

3. Limited Partnership   A limited partnership ("LP") should file a Certificate of Limited Partnership with the Tennessee Secretary of State along with a $100.00 filing fee. An annual report and related fee are not required to be filed with the Tennessee Secretary of State. A LP is required to have at least one general partner to manage the affairs of the partnership. Accordingly, the general partner of an LP may have some personal liability exposure. The limited partners of an LP generally have no personal liability exposure for the actions of the LP Partners in an LP should consider having an attorney prepare a partnership agreement to document the partnership's "rules". An LP is required to file an annual partnership income tax return with the Internal Revenue Service (Form 1065)

as well as an annual franchise, excise tax return with the Tennessee Department of Revenue (Form FAE 170) unless an exemption has been obtained from the Tennessee Department of Revenue. All federal income taxes on the LP are imposed at the individual partners' level and thus the LP pays no federal income tax at the partnership level. An LP must have two or more partners (a minimum of one general partner plus one limited partner). A proper reorganization of an LP into another type of entity generally has minimal tax implications.

4. Limited Liability Company A limited liability company ("LLC") should file Articles of Organization with the Tennessee Secretary of State along with a filing fee ($50.00 per LLC member, minimum of $300.00 and maximum of $3,000.00). An annual report must be filed with the Tennessee Secretary of State along with the annual report fee ($50.00 per member, $300.00 minimum, $3,000.00 maximum). The owners of an LLC are called "members" as compared to "partners" in a partnership or "shareholders" in a corporation. Members in an LLC should consider having an attorney prepare an operating agreement to document the LLC's "rules". An LLC is required to file an annual income tax return with the Internal Revenue Service (small businesses with more than one owner generally file Form 1065 whereas one owner or "single-member" LLC's are disregarded by the IRS and thus are treated as sole proprietorships for federal income tax purposes) as well as an annual franchise, excise tax return with the Tennessee Department of Revenue (Form FAE 170) unless an exemption has been obtained from the Tennessee Department of Revenue. All federal income taxes on the LLC are imposed at the individual member(s) level and thus the LLC pays no federal income tax at the LLC level. An LLC may have one or more members. A professional services business (examples: law, accounting, medicine, dentistry, etc.) may form an LLC, but these entities generally file under a different authority of the Tennessee Code Annotated and become professional limited liability companies or PLLC's. A proper reorganization of an LLC into another type of entity generally has minimal tax implications.

5. Limited Liability Partnership For Tennessee-based businesses that solely conduct their business in the State of Tennessee, an LLC is generally favored versus an LLP. Usually a limited liability partnership ("LLP") is formed by professionals (examples: law, accounting, medicine, dentistry, etc.) and may be chosen as an alternative to an LLC or PLLC. Some states do not recognize an LLC as a limited liability entity and thus the LLP is the only non-corporate entity providing limited liability attributes. An LLP should file an Application for Registration of Limited Liability Partnership with the Tennessee Secretary of State along with a filing fee ($50.00 per partner, $250.00 minimum, $2,500.00 maximum). An annual report must be filed with the Tennessee Secretary of State along with the annual report fee ($50.00 per partner, $250.00 minimum, $2,500.00 maximum). Partners in an LLP should consider having an attorney prepare a partnership agreement to document the LLP's "rules". An LLP is required to

file an annual income tax return with the Internal Revenue Service (Form 1065) as well as an annual franchise, excise tax return with the Tennessee Department of Revenue (Form FAE 170) unless an exemption has been obtained from the Tennessee Department of Revenue. All federal income taxes on the LLP are imposed at the individual partners' level and thus the LLP pays no federal income tax at the partnership level. An LLP must have two or more partners. A proper reorganization of an LLP into another type of entity generally has minimal tax implications.

6. CORPORATIONS The designation of a "C Corporation" versus an "S Corporation" is specific to the Internal Revenue Code under which these types of corporations are taxed. A corporation formed in Tennessee defaults to a C Corporation unless the appropriate election is filed with the IRS to be taxed as an S Corporation. For Tennessee organizational and limited liability purposes, there is no difference between the two.

   a. C Corporation A C Corporation ("C Corp") should file a Charter with the Tennessee Secretary of State along with a $100.00 filing fee. An annual report and related fee of $20.00 are required to be filed with the Tennessee Secretary of State. The shareholder(s) of a C Corp generally have no personal liability exposure for the actions of the C Corp. The shareholder(s) of a C Corp should consider having an attorney prepare By Laws as well as a Shareholder's Agreement to document the C Corp's "rules". The Tennessee Code Annotated requires By Laws for all corporations. A C Corp is required to file an annual corporation income tax return with the Internal Revenue Service (Form 1120) as well as an annual franchise, excise tax return with the Tennessee Department of Revenue (Form FAE 170) unless an exemption has been obtained from the Tennessee Department of Revenue. Federal income taxes on the C Corp are imposed at the corporation level. Additionally, compensation or dividends paid to shareholders of a C Corp are also subject to federal income taxes at the individual shareholder's level. A C Corp may have one or more shareholders. A proper reorganization of a C Corp into another type of entity may have significant income tax implications unless the reorganization qualifies as a tax-free reorganization.

   b. S Corporation An S Corporation ("S Corp") should file a Charter with the Tennessee Secretary of State along with a $100.00 filing fee. An annual report and related fee of $20.00 are required to be filed with the Tennessee Secretary of State. The shareholder(s) of a S Corp generally have no personal liability exposure for the actions of the S Corp. The shareholder(s) of an S Corp should consider having an attorney prepare By Laws as well as a Shareholder's Agreement to document the C Corp's "rules". The Tennessee Code Annotated requires By Laws for all corporations. An S Corp is required to file an annual corporation income tax return with the Internal Revenue Service (Form 1120S) as well as an annual franchise, excise tax return with the Tennessee Department of Revenue (Form FAE 170) unless an exemption has been obtained from the Tennessee Department of Revenue. Federal income taxes on the S Corp are imposed at the shareholder level. Additionally, compensation paid to shareholders of an S Corp is also subject to federal income taxes at the individual shareholder's level. An S Corp may have one to one hundred shareholders (a husband and wife may be treated as one shareholder for this requirement). S corporations can only have the following types of shareholders: individuals, estates, certain trusts, banks, and certain exempt organizations. Partnerships and corporations cannot be shareholders of an S Corp. Only citizens or residents of the United States can be shareholders. The corporation can have only one class of stock. The corporation must timely file a complete IRS Form 2553 – Election by a Small Business Corporation to become an S Corp. A proper reorganization of an S Corp into another type of entity may have significant income tax implications unless the reorganization qualifies as a tax-free reorganization.

Regardless of the type of entity that you select, we encourage you to obtain the appropriate business insurance coverage. Having an entity with limited liability protection alone does not pay the legal fees to defend a lawsuit.

In addition, you should always avoid the commingling of personal and business assets. As the owner of an entity, you may take a distribution, dividend, or payroll check (depending upon the type of entity), but your personal expenses should be paid out of your personal bank account and vice versa. Likewise, failure to conduct related party transactions at "arm's length" could have negative income tax implications, and further could potentially allow a litigant to "pierce the corporate veil" and thus bypass the limited liability protection intended for the entity.