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ASK THE SBDC

Insights for the Entrepreneur

by Mario A. Iezzoni

• Small Business Analyst
USF Small Business Development Center
www.sbdc.usf.edu • miezzoni@coba.usf.edu



Bifurcated LLC

What the heck is a Bifurcated LLC? Essentially, it's a cross between a Limited Liability Partnership and an S Corporation where the managing-member possesses two classes of ownership – a managing interest and an investor interest. With this concept, you're splitting the ownership arrangement of your LLC.

What I like about this type of entity is that it portions the entrepreneur's true business intention, as employee and investor, and rewards the owners accordingly – nearly identical to an S-corp.

Many novice S-corp owners often realize after the fact that filing payroll taxes and corporate tax returns can be confusing, time-consuming and costly – relative to the small amount of compensation doled out in the early stages of their enterprise. The Bifurcated LLC simplifies some of that complexity and offers flexibility, while minimizing the amount of self-employment tax paid.

For example: Jane and Buster create an LLC with a managing-member stake and investment interests. They're entitled to profits and losses in proportion to their share of contributions to the LLC. Unit holders of each ownership stake have the right to one vote per unit. Only holders of the managing units – in this example, Jane – can transact business on behalf of the LLC. Buster's position is limited and passive. Jane acquires one managing unit and 64 investment units. Buster, a passive investor, acquires 35 investment units. As the managing member, Jane receives a guaranteed payment of \$40,000 for her services, basically a "fair market value" for her wage. After deducting Jane's guaranteed payment, the LLC's net profit is \$100,000. Jane reports \$41,000 as self-employment income (1% of \$100,000 for her managing-member position, plus the guaranteed payment). The remaining distributable profits are allotted to their investment interest – \$64,000 to Jane and \$35,000 to Buster – and therefore would not be self-employment income. That's a tax savings of roughly \$15,000.

If you are new to the term guaranteed payments, it's simply a deductible cash payment for services provided to the LLC by the managing-member partner. View it as a wage but without the hassle of payroll tax filings.

Before you run out and form your own Bifurcated LLC you should talk to an attorney and a CPA because there are special circumstances you must be aware of. ■