

Business Structures

There are four main types of business structures. Knowing the type of structure will help the worker identify the tax forms needed for the income calculation.

Sole Proprietorship

Most small businesses are in the legal form of a Sole Proprietorship. A Sole Proprietorship is a type of business entity which legally has no separate existence from its owner.

The business does not file a separate tax return even though it may have an individual Federal Employer Identification Number (FEIN) that is not the owner's social security number. Instead, all the reportable business income and expenses are reported as part of the individual's Federal 1040 Tax Return.

A sole proprietorship can have employees and even offer insurance. The owner can be paid a wage that is reportable via a W-2 tax form. For most very small businesses, the owner does not draw a wage, instead the owner uses the profits from the business as personal income.

A sole proprietorship generally has a single owner (hence the term "sole"), but there can be up to two owners if the owners are married under [special circumstances](#).

A person who operates a Sole Proprietorship will report income via specific schedules as part of the Federal 1040 Income Tax form. The following schedules that may be needed for income verification may include:

- Schedule 1 – Additional Income (identifies business schedules C,E,F, etc.)
- Schedule C – Profit or Loss from Business
- Schedule C EZ – Simple form of Profit or Loss from Business
- Schedule E, Part 1 – Supplemental Income & Loss (for rental property)
- Schedule F – Profit or Loss from Farming (earned income)
- Form 4797 – Business Capital Gains
- Form 8829 – Business use of home

Partnerships

Partnerships are legal entities where two or more individuals form a legal structure to share the costs and profits of a business. Partnerships do not pay taxes but must file an informational federal tax return.

As part of the return, each partner is issued a Schedule K-1, which records each partner's share of income and expense. Individual partners report their share of profits and losses on their personal return via Schedule E, Part 2 and pays personal and employment taxes on that income.

Partners do not get paid wages that are reported on a W-2 form. Instead, partners can take a "Guaranteed Payment".

Guaranteed payments to partners are made to ensure that partners are compensated for specific contributions they make to a partnership, whether in the form of goods or services. This eliminates the risk of their making personal contributions of time or property for which they are never paid if the partnership does not turn a profit for that tax year.

The tax forms associated with a Partnership are:

- Form 1065 – Partnership Business Tax Return
- Schedule K-1 from a Partnership

The K-1 form is used to report income on the 1040 personal tax return. Income from the K-1 is transferred to the **Schedule E, Part 2** as part of the 1040. Guaranteed Payments are reported on the K-1 and transferred the Schedule E, Part 2.

NOTE: There is a K-1 for the 1065 Partnership Return and a K-1 for S-Corporations. They are both called K-1's and look similar but are DIFFERENT. Be sure to look at the Upper Left-Hand corner of the form to identify if it is from a Partnership return (1065) or an S-Corporation return (1120S).

Limited Liability Company (LLC)

An LLC is a legal designation to provide some (hence the term "*limited*") protection to the owners of the business. A sole proprietorship, partnership and S-Corporation can become an LLC and remain taxed as they would be without being an LLC.

S-Corporations

An LLC can choose to be taxed as a corporation, specifically an S-Corporation, which means they would file a separate business return, though the business itself would not pay taxes. The net income of the business is reported on K-1's and the owner(s) of the S-Corporation report the earnings (or loss) on their 1040 personal tax returns via the **Schedule E**.

The tax forms associated with an S-Corporation are:

- Form 1120s – S Corporation Business Tax Return
- Schedule K-1 from a S-Corporation

Unlike Partnership K-1 form, there are no Guaranteed Payments for members of an S-Corporation and those are not listed on the S-Corporation K-1 form.

S-Corporations usually pay their owners/officers of the company a regular wage, generating a W-2 statement at the end of the year. Their pay is separated out on the business tax form as "Compensation to Officers" on the 1120S tax return form. If the owner is being paid wages, it will show on the 1120S under this expense line and a W-2 statement will have been generated. The wage for the owner would then be included in Line 7 of the Schedule 1 of the 1040 form.

Corporations

Corporations are business structures with shareholders as owners. The company pays taxes on the net income earned by the business. The owners of a corporation do not pay taxes on the business income. Each owner or shareholder is allocated their proportion of the profit via dividends, royalties, and capital gains. Those are reported on their personal tax return.

- Form 1120 – Corporation Business Tax Return