

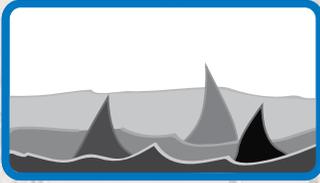


ASSURANT  
Employee  
Benefits®

# Business Entities

## EDUCATION MATERIALS

### UNDERINSURANCE



Owner's monthly pay definition does not capture expected earnings

### NO BENEFIT PAYABLE



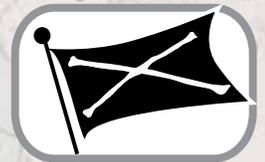
Owner's fluctuation in earnings not considered

### DELAY IN CLAIM DETERMINATION



Facts not discussed in sales process

### LACK OF INSURANCE



Owner not included in eligible class

*With our help, business owners can navigate through potentially treacherous waters.*

Assurant. On your terms.®

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# Table of Contents

Introduction .....	Page 3
Frequently Asked Questions - General Topics .....	Page 4
Business Entities Chart - Key Characteristics .....	Page 6
What is the Business Entity? - Questions to help you identify the type of business entity .....	Page 7
Business Entities - Detailed descriptions of each entity	
a. Sole Proprietorships .....	Page 8
b. Partnerships .....	Page 10
c. Limited Partnerships.....	Page 13
d. Corporations .....	Page 16
e. Subchapter S Corporations .....	Page 18
f. Professional Corporations/Professional Associations.....	Page 21
g. Limited Liability Companies .....	Page 24
Associated Companies .....	Page 28
Glossary of Terms .....	Page 30

## Introduction

The type of legal entity through which a business is operated is a decision made by the owners of that business. A number of factors can drive this decision: the business itself, protection of the owners' personal assets, tax planning, etc. *An additional aspect of this decision also needs consideration - how the type of business entity impacts how the business owner is treated under a group insurance policy issued to that business.*

These Educational Materials were created to provide our trusted sellers a basic guide to understanding seven types of business entities and information about some important differences that can impact business owners. This guide will also help you ask the right questions to obtain necessary information about the business entity and owner(s) so that you can discuss the insurance needs for the business owner with the group insurance carrier.

### Why take the time to understand business entities?

Taking time early in the sales process to understand the type of business entity the owner has formed and the types of earnings the business owner receives from that entity can pay dividends for brokers and owners, especially if the business owner later files a claim for benefits under the policy. Understanding your business owner customers' needs and having those discussions with the insurance carrier as part of the sales process can reduce the potential for certain unintended consequences for the business owner –

- Underinsurance
- Lack of insurance
- No benefit payable
- Delay in benefit determinations

We encourage these types of discussions during the sales process, the earlier the better. While our standard policy provisions often meet the needs of business owners, there is occasion when they do not address a client's particular situation. Recognizing those situations and having discussions early on benefits all parties.

*Please continue reading to learn how to help protect business owners against potential unintended consequences.*

## Frequently Asked Questions - General Topics

### Q1 What is a business entity?

A1 A business entity is a legally recognized means of conducting a lawful business under state law. Each of the business entity types discussed in these materials is a legally recognized means of conducting business in the United States. A business entity type is not the SIC code or the industry in which the business operates but the industry may tend, in some instances, to determine the type of business entity through which the business is operated. For example, physicians and lawyers tend to form professional corporations, professional associations, or limited liability companies.

### Q2 Why does the type of business entity matter to a group insurance carrier?

A2 If the business owner is intended to be covered under a group insurance policy along with the employees of that business, the group insurance carrier needs to know the type of business entity for several reasons. First, the group insurance carrier must verify that the owner can be covered under the applicable state eligible group insurance laws and within the insurer's underwriting guidelines. Second, if those laws permit the business owner to be covered, the group insurance policy may have to be modified to reflect the fact that the business owner is covered as well as the common law employees of that business because some business owners are not considered employees. Third, in the case of group life or disability insurance coverages, the standard weekly, monthly, and annual pay definitions should be reviewed. As these materials will show, some business owners are not compensated in the same manner as their employees. For this reason the group policy may have to be modified to reflect appropriate weekly, monthly, and/or annual pay definitions for business owners. Addressing these issues when business owners are to be covered under a group insurance policy can reduce the potential for unintended consequences for the business owner, especially if a claim is filed.

### Q3 What is the best way to analyze a business entity for group insurance purposes?

A3 The threshold question for group insurance purposes is who is the policyholder. Once the policyholder is ascertained, what is the legal name of that entity? Then the question becomes who is to be covered under that group policy? What is the relationship of those individuals to the policyholder? Answering these questions provide the basic information needed to understand the basics about the policyholder and who can be covered under the group policy.

### Q4 Can the type of business entity through which a business operates be changed; for example, can a corporation become a limited liability company?

A4 Yes, the type of business entity can be changed. In this example, the corporation would be dissolved and a new legal entity is created, the limited liability company. The new limited liability company cannot use the corporation's taxpayer identification number because the limited liability company is a new legal entity, not a continuation of the corporation.

### Q5 Does the group insurance carrier need to know that the business entity has changed?

A5 Yes, the group insurance carrier should be notified promptly so that any required changes to the group insurance policy can be made. At a minimum, the name of the policyholder may need to be changed. Depending on the new business entity type and who is covered under the group insurance policy, changes to the eligible class and weekly, monthly, and annual pay may be necessary if the business owners are to be covered under the group insurance policy.

### Q6 Why do business owners create different types of business entities?

A6 There are different reasons a business owner might choose a particular type of business entity through which the business is operated. For some business owners, the primary concern is protecting the business owner's personal assets from the debts and liabilities of the business entity. Operating the business through a corporation provides this type of liability protection. For other owners, taking advantage of the tax laws to eliminate the double taxation of the business' net income is of prime importance. Creating a pass-through entity for tax purposes such as a partnership achieves this goal. Certain types of business entities such as a limited liability company are pass-through entities that also provides business owners some degree of personal liability protection. For certain other business owners, the type of business entity through which the business can be operated may be dictated by state law. For example, banks and insurance companies must do business as corporations.

**Q7 How can a particular type of business entity protect the business owner's personal assets?**

**A7** The legal characteristics of certain types of business entities allow the business owner to shield, to varying degrees, the business owner's personal assets from the debts and liabilities of the business entity. As a result, only the assets of the business entity, not those of the owner, are subject to the claims of the business entity's creditors. Some business owners may create multiple entities in order to further protect not only the business owner's personal assets, but also the assets of each business entity from the debts and liabilities of a related entity, all of which are each owned in whole or in part by the business owner. For more information, see Associated Companies.

**Q8 Do the owners of a business entity have to be individual persons?**

**A8** Except for sole proprietorships, no. The owners of a business entity other than a sole proprietorship can be individual persons, other business entities, or a combination of individual persons and business entities. The owner of a sole proprietorship must be an individual person. Only individual persons can be insured under a group insurance policy.

**Q9 What is the importance of the legal name of a business entity?**

**A9** The legal name of an entity can assist in determining the type of business entity. For example, a sole proprietorship's legal name will be the name of the sole proprietor; a corporation should have Incorporated, Inc., Corporation or Corp. as part of its legal name; a limited liability company should have LLC, LC or PLC (professional limited liability company) as part of its name. Under state laws, certain business entities are required to include a required descriptor in their legal names in order to put creditors and other persons on notice that the owners' liability is limited.

**Q10 Can a dba (doing business as) be the legal name of a business entity?**

**A10** No, a dba is a business or trade name, not a legal name. In some states a dba is considered a fictitious name which must be registered before use of that name in the state.

**Q11 How do we address business owners in its group policies?**

**A11** Our standard policy language recognizes business owner eligibility and covered monthly pay so long as the business entity type is accurately provided on the group preliminary application for insurance. See Business Entities and Your Disability Contract for our standard monthly pay definitions applicable to the business entities discussed in the materials.

**Q12 What do I need to do if the standard monthly pay definitions don't meet the needs of the business owner?**

**A12** Non-standard monthly pay definitions require underwriting approval. Your Assurant Employee Benefits sales representative will be able to forward your request for underwriting consideration.

# Business Entities Chart

## – Key Characteristics

	Sole Proprietorships	Partnerships	Limited Partnerships	Corporations (Subchapter C Corporations)	Subchapter S Corporations	Professional Corporations/ Professional Associations	Limited Liability Companies
Policyholder Name	Individual doing business as (dba) trade name ex. John Doe dba John's Repair Shop	Any name but cannot use LP, Corp, Inc., LLC, etc. Name does not have to use "partnership" ex. Baker & Cake	Limited Partnership Limited, Ltd, or L.P. must appear ex. New Well 3, LP	Incorporated, Inc., Corporation Corp., Limited, Ltd. ex. Napkins, Inc.	Incorporated, Inc. Corp., Corporation, Limited, Ltd. ex. Best Things, Inc.	Professional Corporation, P.C. Professional Association, P.A., SC ex. Wells, Jones & Barr P.C.	LC, LLC, Ltd. Limited, PLC, PLLC ex. Street, Main & Grand, LLC
What Owners are Called	Sole Proprietor	Partners	General Partner(s) Limited Partner(s)	Shareholder(s)	Shareholder(s)	Shareholder(s)	Member(s)
Required Number of Owners	No more than 1	2 or More	2 or More	1 or More	100 or Less	1 or More	1 or More
How Formed	No formal requirements	<ul style="list-style-type: none"> <li>Can be formal or informal</li> <li>Generally a written partnership agreement</li> <li>May file with Secretary of State</li> </ul>	Formal filing with Secretary of State	Formal filing with Secretary of State	<ul style="list-style-type: none"> <li>Formal filing with Secretary of State</li> <li>Must make a federal income tax election to be treated as a subchapter S corporation</li> </ul>	Formal filing with Secretary of State	<ul style="list-style-type: none"> <li>Formal filing with Secretary of State</li> <li>The IRS check-the-box rules control tax entity</li> </ul>
Stock Issued	No	No	No	Yes-Can be multiple classes	Yes-Must have only 1 class	Depends on state law	Generally No
Owner – Participation in Management	Yes	Yes	Gen. partner – Yes Lmtd. partner – No	Yes-Indirect	Yes	Yes	Yes-Unless Manager Managed
Owner – Liability for Company Debts	Yes	Yes	Gen. partner – Yes Lmtd. partner – No	No	No	No	No

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## What is the Business Entity?

### Questions to help identify the type of business entity

1. What is legal name of entity?
2. Does the legal name include Inc., Incorporated, Corp., or Corporation?
  - a. If yes, the entity is a *corporation*.
  - b. The entity could be a *Subchapter S Corporation*. You have to ask.
3. Does the legal name include P.C., Professional Corporation, P.A., or Professional Association?
  - a. If legal name includes P.C. or Professional Corporation, the entity is a professional corporation.
  - b. If legal name includes P.A. or Professional Association, the entity is a professional association.
4. Does the legal name include Limited or LTD? If yes, entity could be a corporation, a subchapter S corporation, a limited partnership, or a limited liability company. You have to ask.
5. Does the legal name include any of the following: LC, LLC, PLLC, PLC, LP, or LLP? If no, go to question 6.
  - a. If the legal name includes LC, LLC, PLLC, or PLC, the entity is a limited liability company.
  - b. If the legal name includes LP, the entity is a limited partnership.
  - c. If the legal name includes LLP, the entity is a limited liability partnership.
6. Does the name include a dba (doing business as) i.e.; William Smith dba Strumming Strings?
  - a. How many owners does the entity have? If one, it may be a sole proprietorship, if two, it may be a partnership.

### Other Clues:

1. Is the entity a professional group such as attorneys, doctors, etc? If yes, entity could be a partnership, LLC, PLLC, LLP, professional corporation, or professional association.
2. Is the entity formed for a single business purpose such as drilling in one area, or developing property in a single area? If yes, entity could be a limited partnership (LP), LLC, or other entity.
3. Is the entity a bank, insurance company, or other financial institution? If yes, entity is likely a corporation.

# Sole Proprietorships

## General Information

**Q1** What is a sole proprietorship?

**A1** A sole proprietorship is the most common form of unincorporated means of conducting business with only one owner. The owner is called a sole proprietor. A sole proprietorship is not a separate legal entity. All actions against the sole proprietorship or on behalf of the business conducted through the sole proprietorship must be made by and in the name of the sole proprietor.

**Q2** What is the legal name of a sole proprietorship?

**A2** The legal name of a sole proprietorship is the name of the sole proprietor. The business name is a doing business as (dba) name. Depending on state law, the sole proprietor may be required to file the business name as a fictitious name prior to use.

**Q3** How is a sole proprietorship formed?

**A3** A sole proprietorship is easy and inexpensive to form and can be formed by default. A sole proprietorship can be formed by default simply by an individual holding him or herself out to be in business. For example, John has a lawn mowing business in which he mows lawns evenings and weekends. John has not formally created any other type of business entity so, by default, John's lawn mowing business is a sole proprietorship.

**Q4** What is the major disadvantage of doing business as a sole proprietorship?

**A4** Because the sole proprietor and the sole proprietorship are legally deemed to be one in the same, the sole proprietor is personally liable for the debts and liabilities of the business. As a result, the personal assets of the sole proprietor, those assets not connected with the business, are potentially subject to claims of creditors of the sole proprietorship. In other words, there is no separate business entity that acts as a shield for the personal assets of the sole proprietor. For this reason, sole proprietorships are a risky form of doing business.

**Q5** Can a sole proprietorship have employees?

**A5** Yes. A sole proprietorship can employ employees to perform work for the sole proprietorship.

**Q6** Can a sole proprietorship be sold to another person or entity?

**A6** The sole proprietorship itself cannot be sold to a third party. Only the assets of the sole proprietorship can be sold.

## Compensation/Tax

**Q7** How is a sole proprietor compensated?

**A7** A sole proprietor can receive compensation from the sole proprietorship but that compensation is not treated as wages paid to an employee because a sole proprietor is not considered an employee of the sole proprietorship for federal income tax purposes. Compensation received by the sole proprietor, whether paid in cash or property, is treated as earnings from self-employment.

**Q8** Does a sole proprietor receive an IRS Form W-2 from the sole proprietorship?

**A8** No. The sole proprietor is not an employee of the sole proprietorship. The sole proprietor is considered a self-employed person and the income received by the sole proprietor from the sole proprietorship is subject to self-employment taxes.

**Q9** Is the sole proprietorship a taxable entity separate from the sole proprietor?

**A9** No. A sole proprietorship is not a separate taxable entity. Rather, a sole proprietorship is a pass-through entity. The income and expenses of the sole proprietorship are "passed through" to the sole proprietor who reports those amounts on his/her own individual income tax return, IRS Form 1040, Schedule C. There is no obligation that the sole proprietorship file a separate annual return.

**Q10** Does a sole proprietorship have to have its own employer identification number since it is a pass-through entity or is it acceptable to use the sole proprietor's social security number?

**A10** The IRS strongly recommends that sole proprietorship **not** use the sole proprietor's social security number. A sole proprietorship should have its own separate employer identification number which can be obtained from the IRS by filing an IRS Form SS-4, Application for Employer Identification Number.

- Q11** Is a sole proprietor eligible for the tax-favored treatment under employee benefit programs sponsored by the sole proprietorship?
- A11** No. The sole proprietor is not considered an employee of the sole proprietorship for fringe benefit purposes.
- Q12** If the sole proprietorship sponsors a Section 125 plan for its employees, is the sole proprietor eligible to participate in the Section 125 plan?
- A12** No. A sole proprietor is not eligible to participate in the Section 125 plan because the sole proprietor is not considered an employee for purposes of I.R.C. Section 125.

## Group Insurance

- Q13** Can a group insurance policy be issued to a sole proprietorship?
- A13** Yes. A sole proprietorship can be a policyholder of a group insurance policy covering the common law employees of the sole proprietorship.
- Q14** If a sole proprietorship purchases a group insurance policy to provide benefits to its employees, can the sole proprietor be covered under that group insurance policy since the sole proprietor is not considered an employee of the sole proprietorship for tax purposes?
- A14** Yes. State eligible group statutes allow a group insurance policy issued to a sole proprietorship to cover the sole proprietor as well as the employees of the sole proprietorship. However, our underwriting rules generally require that the sole proprietor must be at active work for the sole proprietorship in order to be covered.
- Q15** What types of compensation of a sole proprietor will we take into account in determining weekly, monthly, and annual pay definitions in its group insurance policies?
- A15** We will cover a sole proprietor's draw or salary received by the sole proprietor from the sole proprietorship for the prior calendar year. See *Sole Proprietorship section of Business Entities and Your Disability Contract* for additional information.

## Taxation of Premium & Benefits

### Employer-Paid Premium

Product	Sole Proprietor	Common Law Employees of Sole Proprietorship
<b>Life</b>		
Premium	Taxable	Up to \$50,000 face amount, not taxable* Over \$50,000 taxable based on imputed income
Proceeds	Not taxable income to beneficiary	Not taxable income to beneficiary
Interest on Proceeds	Taxable	Taxable
<b>Disability</b>		
Premium	Taxable	Not Taxable
Disability Benefits	Not Taxable	Taxable
<b>Dental/Vision</b>		
Premium	Taxable	Not Taxable
Dental/Vision Benefits	Not Taxable	Not Taxable

\*If plan discriminatory under I.R.C. §79, premium is taxable to key employees.

# Partnerships

## General Information

**Q1** What is a partnership?

**A1** A partnership is the most common form of unincorporated business entity with two or more owners. The owners are called partners.

**Q2** What is the legal name of a partnership?

**A2** The legal name of a partnership is whatever name that is chosen by the partners. There is no requirement that the legal name include “partnership.”

**Q3** How is a partnership formed?

**A3** A partnership can be formed by default or can be a formal arrangement with a complex negotiated partnership agreement. A partnership can be formed by default simply by two or more individuals holding themselves out to be in business.

**Q4** What is the major disadvantage of doing business as a partnership?

**A4** The major disadvantage of doing business as a general partnership is that the partners are jointly and severally liable for the debts and liabilities of the partnership as well as for liabilities that arise from the acts of other partners of the partnership. As a result, the personal assets of the partner can be subject to the claims of creditors of the partnership and the creditors of the other partners of the partnership. There is no separate business entity that acts to shield the personal assets of the partner. For this reason, partnerships can be a risky form of doing business.

**Q5** Is there any way for a general partnership to shield the personal assets of its partners from the claims of partnership creditors?

**A5** Yes. General partnership may be able to elect to be treated as a limited liability partnership (LLP) if permitted under state law. This election provides some protection to the personal assets of the partners. For partners of a LLP, each partner’s liability is limited to the liabilities arising from the partner’s own wrongdoing plus the liabilities arising from those over whom the partner has supervisory duties. Depending on state law, a LLP partner may also be shielded from the wrongful acts of the other partners as well as the liabilities of the LLP itself. LLPs are often formed by professionals to shield each partner from the malpractice that may be committed by other partners.

**Q6** How can I tell that a partnership is a limited liability partnership?

**A6** The laws of most states require that a limited liability partnership include as part of its legal name either the words “a limited liability partnership” or LLP. Some states also require an annual filing with the Secretary of State to maintain the status as a limited liability partnership. Failure to register does not dissolve the partnership, so it continues as a valid business entity but the liability shield provided by the LLP is lost for the partners.

**Q7** Do the partners of a partnership have to be individual persons?

**A7** No. The partners of a partnership can be individual persons, other business entities, or a combination of individual persons and other business entities. The partners of partnerships formed by professionals such as lawyers and doctors may be professional corporations or limited liability companies rather than individual persons in order to limit the liability of the professionals. Structuring the ownership of a partnership in this manner is another means by which the personal assets of the individual partner can be shielded from the liabilities of the partnership and those of the other partners. See Associated Companies.

**Q8** Can a partnership have only one owner?

**A8** No. A partnership must have two or more owners. If one partner of a two partner partnership dies, files bankruptcy, or withdraws from the partnership, the partnership is dissolved by operation of law. If the remaining partner chooses to continue the business alone, that person must form a different type of legal entity.

## Compensation/Tax

**Q9** How are partners of a partnership compensated?

**A9** Partners are not considered employees of the partnership for federal income tax purposes. As such, partners of a partnership do not receive a salary from the partnership that is treated as wages. Partners may receive a periodic draw that is generally determined as of the beginning of the partnership's tax year and periodically "trued up" based on actual net income received by the partnership. Some partners may also receive guaranteed payments from the partnership. Partners may also receive a distribution after the close of the year depending on partnership profits. The partner's draw and distribution are determined in accordance with a written partnership agreement based on the partner's profit's share ownership of the partnership. In the event of a net loss to the partnership, partners may be required to contribute additional capital to the partnership.

**Q10** Do partners of a partnership receive an IRS Form W-2 from the partnership?

**A10** No. Capital or equity partners are not treated as employees of the partnership. Capital or equity partners are considered self-employed persons who are subject to self-employment taxes.

**Q11** How are partner's earnings from self-employment determined?

**A11** A partner's earnings from self-employment is the sum of the partner's distributive share of partnership net income (ordinary income) plus guaranteed payment the partner received from the partnership both as reported by the partnership on the Partner's Schedule K-1, IRS Form 1065.

**Q12** What is the difference between ordinary income and guaranteed payments as reported on the Partner's Schedule K-1, IRS Form 1065?

**A12** Ordinary income is that portion of the partnership's net income that is allocable to the partner based on the partner's capital (or profits) interest percentage. Guaranteed payments represent income that is payable to a partner by the partnership regardless of partnership income. Guaranteed payments are not treated as wages so there is no withholding of income or employment taxes from guaranteed payments. Guaranteed payments are treated as earnings from self employment and are subject to self-employment taxes.

**Q13** If a partner receives guaranteed payments from the partnership, are those amounts reported on an IRS Form W-2?

**A13** No. Guaranteed payments are not wages that are reportable on an IRS Form W-2. The fact that a partner receives guaranteed payments does not make the partner an employee of the partnership. Guaranteed payments are reported on the Partner's Schedule K-1, IRS Form 1065 and are subject to self-employment taxes.

**Q14** Is a partnership a separate taxable entity?

**A14** No. While a partnership must file an annual IRS Form 1065, there is no taxation at the partnership level on partnership net income. A partnership is a pass-through entity from which the income and expenses of the partnership are "passed-through" to the partners. Each partner's distributive share of the partnership's income and expenses are reported to the partner by the partnership on the Partner's Schedule K-1, IRS Form 1065. The individual partner is required to report these items on the partner's individual IRS Form 1040 for the tax year.

**Q15** Are the partners of a partnership eligible for the tax-favored treatment under the employee benefit programs sponsored by the partnership?

**A15** No. Partners of a partnership are not considered employees of the partnership for fringe benefit purposes.

**Q16** Can partners of a partnership participate in a Section 125 plan that is sponsored by the partnership?

**A16** No. The partners of a partnership are not eligible to participate in the partnership-sponsored Section 125 plan because the partners are not considered employees for purposes of I.R.C. Section 125.

## Group Insurance

**Q17** Can a group insurance policy be issued to a partnership?

**A17** Yes. A partnership can be a policyholder of a group insurance policy covering the common law employees of the partnership.

**Q18** If a partnership purchases a group insurance policy to provide benefits to its employees, can the partners be covered under that group insurance policy since the partners are not considered employees of the partnership?

**A18** Yes. State eligible group statutes allow a group insurance policy issued to a partnership to cover the partners as well as the employees of the partnership. Our underwriting rules generally require that the partners can only be covered if they are at active work for the partnership.

*Caution: Any partners who are not individuals will not be covered unless the partners are associated companies listed in the group insurance policy. For example, if a partner is a professional corporation, the shareholder of that professional corporation is not a covered person under the group insurance policy unless the professional corporation is listed as an associated company in the group insurance policy. See Associated Companies.*

**Q19** What types of compensation of a partner will we take into account in determining weekly, monthly, and annual pay definitions?

**A19** We will cover a partner's ordinary income, guaranteed payments, a combination of ordinary income and guaranteed payments, or net income subject to self-employment taxes, all as reported by the partnership on the Partner's Schedule K-1, IRS Form 1065 for the prior calendar year. See the *Partnerships* section of *Business Entities and Your Disability Contract* for additional information.

## Taxation of Premium & Benefits

### Employer-Paid Premium

Product	Partner	Common Law Employees
<b>Life</b>		
Premium	Taxable	Up to \$50,000 not taxable* Over \$50,000 taxable based on imputed income
Group Term Life Proceeds	Not taxable income to beneficiary	Not taxable income to beneficiary
Interest on Group Term Life Proceeds	Taxable	Taxable
<b>Disability</b>		
Premium	Taxable	Not Taxable
Disability Benefits	Not Taxable	Taxable
<b>Dental/Vision</b>		
Premium	Taxable	Not Taxable
Dental/Vision Benefits	Not Taxable	Not Taxable

\*If plan discriminatory under I.R.C. §79, premium is taxable to key employees.

# Limited Partnerships

## General Information

**Q1 What is a limited partnership?**

**A1** A limited partnership is a type of partnership. Limited partnerships are formed under the limited partnership laws of each state and require a formal filing with the state.

**Q2 What is the legal name of a limited partnership?**

**A2** The legal name of a limited partnership must include one of the following: Limited Partnership, Limited, Ltd., or L.P.

**Q3 Who are the owners of a limited partnership?**

**A3** The owners of a limited partnership must include at least one general partner and one or more limited partners.

**Q4 What is the difference between a partnership and a limited partnership?**

**A4** The primary purpose of a limited partnership is to limit the liability of the limited partners. For this reason the major difference between a general partnership and a limited partnership is that the liability of the limited partners for partnership debts and liabilities is limited to the limited partner's investment in the limited partnership. As a result, the personal assets of a limited partner are generally protected from the creditors of the limited partnership and the creditors of the general partner. Only the general partner(s) remain liable for the debts and liabilities of the limited partnership.

**Q5 What is the difference between a general partner and a limited partner?**

**A5** A general partner has all of the characteristics of a partner of a partnership. A limited partner is treated as an investor and has no liability for debts and liabilities of the limited partnership beyond the amount the limited partner has invested. In contrast, a general partner is jointly and severally liable for the debts and liabilities of the limited partnership. Because a limited partner is considered an investor in the limited partnership, a limited partner cannot participate in the management or otherwise control the business of the limited partnership.

**Q6 Why does a limited partnership have to have at least one general partner?**

**A6** A limited partnership must have at least one general partner because someone (individual or entity) must be accountable and liable for the obligations, debts, and liabilities of the limited partnership. A limited partnership is a type of partnership which retains the characteristics of a partnership except as to the limited partners. Without a general partner, a limited partnership cannot exist.

**Q7 Do the general and/or limited partners have to be individual persons?**

**A7** No. The general and/or limited partners of a limited partnership can be other business entities such as corporations, limited liability companies, etc. Even though the owners may be other business entities, those entities each retain the attributes of a general partner or limited partner in relation to the limited partnership. See Associated Companies.

**Q8 Is there a way for the general partner of a limited partnership to protect its assets from claims of the limited partnership's creditors?**

**A8** Yes. The limited partnership may be able to elect to be treated as a limited liability limited partnership (LLLP) if permitted under state law. Electing to become a LLLP serves to protect the assets of the general partner from the debts and liabilities of the limited partnership. As with a limited liability partnership, an LLLP must file with the secretary of state as an LLLP in the state where the limited partnership is formed and comply with any state law requirements to maintain that status. If an LLLP fails to comply with state law requirements, the entity does not dissolve but reverts to a limited partnership and continues to operate as a limited partnership. The laws of California, New York, and Oregon do not recognize limited liability limited partnerships.

**Q9 What types of businesses form limited partnerships?**

**A9** Businesses that need large amounts of capital from investors may choose to form a limited partnership rather than a corporation so that the general partner can retain control of the business. Another reason that a business may be formed as a limited partnership is to "wall off" risk in one business entity which is part of a larger business operation. Examples of industries that may form limited partnerships include oil drilling and exploration firms, real estate developers, and real estate management companies.

## Compensation and Tax

**Q10** How is a limited partner of a limited partnership compensated?

**A10** A limited partner of a limited partnership is considered an investor whose compensation takes the form of a return on that investment. A limited partner's distributive share of the limited partnership income is not considered earnings from self-employment. However, if the limited partner receives a guaranteed payment from the limited partnership, the guaranteed payment is considered earnings from self-employment.

**Q11** How is a general partner of a limited partnership compensated?

**A11** A general partner of a limited partnership is compensated in the same manner as a partner in a partnership. *See Partnerships.*

**Q12** Do the general partner(s) of a limited partnership receive an IRS Form W-2 from the limited partnership?

**A12** No. The general partner(s) of a limited partnership will not receive an IRS Form W-2 from the limited partnership. The general partner's proportionate share of income and deductions will be reported by the limited partnership on the Partner's Schedule K-1, IRS Form 1065.

**Q13** Do the limited partners of a limited partnership receive an IRS Form W-2 from the limited partnership?

**A13** A limited partner of a limited partnership will receive an IRS Form W-2 from the limited partnership **only if** the limited partner is also a common law employee of the limited partnership. Any amounts received in the capacity of a limited partner of the limited partnership will be reported by the limited partnership to the limited partner of the Partner's Schedule K-1, IRS Form 1065.

**Q14** Is a limited partnership a separate taxable entity?

**A14** No. A limited partnership is a partnership for federal income tax purposes and must file an annual IRS Form 1065. However, there is no taxation at the limited partnership level. *See Partnerships.*

**Q15** Are the general and limited partners eligible for the tax favored treatment under employee benefit programs sponsored by the limited partnership?

**A15** No. The general partners are not considered employees of the limited partnership for fringe benefit purposes. Limited partners who are only investors are not eligible to be covered under employer-sponsored benefit plans.

**Q16** Can the general or limited partners of a limited partnership participate in a Section 125 plan that is sponsored by the limited partnership?

**A16** No. The general partners cannot participate in the Section 125 plan because general partners are not considered employees for purposes of I.R.C. Section 125. If a limited partner is in fact a common law employee of the limited partnership, the limited partner may be eligible to participate in the Section 125 plan.

## Group Insurance

**Q17** Can a group insurance policy be issued to a limited partnership?

**A17** Yes. A limited partnership can be a policyholder of a group insurance policy covering the common law employees of the limited partnership.

**Q18** If a limited partnership purchases a group insurance policy to provide benefits to its employees, can the general and limited partners be covered under that group insurance policy?

**A18** State eligible group statutes allow a group insurance policy issued to a limited partnership to cover the partners as well as the employees of the limited partnership. However, our underwriting rules generally require that the general and/or limited partners can only be covered if they are at active work for the limited partnership.

*Caution: Any general or limited partners that are not individuals will not be covered unless the general and/or limited partner(s) are listed in the group policy as associated companies. For example, if a general partner is a limited liability company, the members and common law employees of that limited liability company will not be covered unless the limited liability company is listed as an associated company in the group insurance policy. See Associated Companies.*

**Q19** What compensation of a general partner will we take into account in determining weekly, monthly, and annual pay definitions?

**A19** We will cover the same types of compensation that it would cover for a partner of a partnership; that is, the general partner's ordinary income, guaranteed payments, a combination of ordinary income and guaranteed payments, or net income subject to self-employment taxes, all as reported by the limited partnership on the Partner's Schedule K-1, Form 1065 for the prior calendar year.

**Q20** What compensation of a limited partner will we take into account in determining weekly, monthly, and annual pay definitions?

**A20** The threshold question for covering a limited partner is whether the limited partner is at active work for the limited partnership. If the limited partner is merely an investor, the limited partner will not be covered under a group insurance policy. If the limited partner is at active work, the compensation that we will take into account will depend upon what capacity the limited partner works for the limited partnership and how the limited partner is compensated. See the *Limited Partnership* section of *Business Entities and Your Disability Contract* for additional information.

## Taxation of Premium & Benefits

### Employer-Paid Premium

Product	General Partner Limited Partners**	Common Law Employees
<b>Life</b>		
Premium	Taxable	Up to \$50,000 not taxable* Over \$50,000 taxable based on imputed income
Group Term Life Proceeds	Not taxable income to beneficiary	Not taxable income to beneficiary
Interest on Group Term Life Proceeds	Taxable	Taxable
<b>Disability</b>		
Premium	Taxable	Not Taxable
Disability Benefits	Not Taxable	Taxable
<b>Dental/Vision</b>		
Premium	Taxable	Not Taxable
Dental/Vision Benefits	Not Taxable	Not Taxable

\*If plan discriminatory under I.R.C. §79, premium is taxable to key employees.

\*\* Limited partner may be taxed as either a partner or a common law employee depending upon the facts and circumstances.

# Corporations

## General Information

**Q1** What is a corporation?

**A1** Unlike sole proprietorships and partnerships, a corporation is a separate legal entity apart from its owners. A corporation is a creature of state law and can only be formed by complying with state law requirements for forming a corporation. A corporation can be formed by individuals or by other business entities.

**Q2** What is the legal name of a corporation?

**A2** The legal name of a corporation must include one of the following: Incorporated, Inc., Corporation, Corp., Limited, or Ltd. Including one of these terms within the legal name puts creditors and other persons on notice that the shareholders' liability for the corporation's debts and liabilities is limited.

**Q3** Who are the owners of a corporation?

**A3** The owners of a corporation are the shareholders or stockholders whose ownership interest is represented by the shares of stock owned by a shareholder.

**Q4** What is the major advantage of doing business as a corporation?

**A4** The major advantage of doing business as a corporation is that the shareholder's liability exposure is limited to the shareholder's investment in the corporation. The shareholder generally is not liable for the debts and liabilities of the corporation. Because a corporation is a separate legal entity, generally only the corporation's assets can be used to settle the corporation's debts and liabilities.

**Q5** What are some other advantages of doing business as a corporation?

**A5** Because a corporation is a separate legal entity, corporations have the ability to attract capital contributed by investors in exchange for a stock certificate. Those investors can, in some instances, easily and freely liquidate their investment in the corporation by selling their shares of stock either to third persons or back to the corporation without impacting the continued existence of the corporation. This ability to liquidate the investment in the corporation does not exist with certain other business entities. For example, a partner in a partnership must have approval of all other partners in order to sell his/her partnership interest to another partner or a third party.

**Q6** What is a disadvantage of doing business as a corporation?

**A6** One disadvantage of doing business as a corporation is that the corporation's net income is subject to double taxation; first at the corporate level and those profits are again taxed as they are distributed by the corporation to shareholders as dividends.

## Compensation/Tax

**Q7** How are shareholders of a corporation compensated?

**A7** As investors, shareholders of a corporation are compensated in two ways: first, by the corporation's distribution of its profits to shareholders in the form of dividends, and second, by the increase or decrease in the value of the shares of stock held by the shareholder.

**Q8** Can the shareholders of a corporation be employed by the corporation?

**A8** Yes. Shareholders can be common law employees of the corporation. As a common law employee, that employee/shareholder will receive an IRS Form W-2 from the employer corporation reporting the wages, salary, and other compensation paid to the employee by the corporation for work performed for the corporation.

**Q9** Will the IRS Form W-2 received by an employee/shareholder include any dividends received from the corporation?

**A9** No. The status of the employee/shareholder is split for tax reporting purposes. Any wages, salary, and other compensation paid to the shareholder as an employee of the corporation is reported on an IRS Form W-2. Any dividends paid to the shareholder as an investor of the corporation are reported separately by the corporation to the shareholder on IRS Form 1099-DIV. Only the wages, salary, and other compensation reported on the employee's IRS Form W-2 is subject to federal, state, and local income tax and employment tax withholding.

- Q10** Is a corporation a separate taxable entity?
- A10** Yes. A corporation is a separate taxable entity under subchapter C of the Internal Revenue Code. A corporation must file an annual IRS Form 1120 and pay any tax that is due on its net income.
- Q11** Are employee/shareholders of a corporation eligible for the tax-favored treatment under the employee benefit programs sponsored by the corporation?
- A11** Yes. Employee/shareholders are common law employees and are eligible for the tax advantaged treatment under employee benefit programs sponsored by the corporation.
- Q12** Can employee/shareholders of a corporation participate in a Section 125 plan sponsored by the corporate employer?
- A12** Yes. The fact that an employee may also be a shareholder of the corporation does not prevent the employee/shareholder from participating in the corporate employer's Section 125 plan.

## Group Insurance

- Q13** Can a group insurance policy be issued to a corporation?
- A13** Yes. A corporation can be a policyholder of a group insurance policy covering the common law employees of the corporation (including the shareholders who are also common law employees).
- Q14** What compensation of a common law employee of a corporation will we take into account in determining weekly, monthly, and annual pay definitions?
- A14**

We will cover a common law employee's basic monthly pay received from the corporate employer. Other types of compensation received from the corporate employer may be covered with underwriting approval. However, any dividends received by an employee/shareholder will not be covered as compensation received from the corporate employer. The employee/shareholder's status as a shareholder is totally disregarded for the purposes of a group insurance policy. See the *Corporations Section of Business Entities and Your Disability Contract* for additional information.

## Taxation of Premium & Benefits

### Employer-Paid Premium

Product	Common Law Employees
<b>Life</b>	
Premium	Up to \$50,000 not taxable* Over \$50,000 taxable based on imputed income
Group Term Life Proceeds	Not taxable income to beneficiary
Interest on Group Term Life Proceeds	Taxable
<b>Disability</b>	
Premium	Not Taxable
Disability Benefits	Taxable
<b>Dental/Vision</b>	
Premium	Not Taxable
Dental/Vision Benefits	Not Taxable

\*If plan discriminatory under I.R.C. §79, premium is taxable to key employees.

## Subchapter S Corporations

### General Information

**Q1** What is a subchapter S corporation?

**A1** A subchapter S corporation is a corporation that has elected to be taxed under subchapter S of the Internal Revenue Code.

**Q2** Can any corporation elect to be taxed under subchapter S of the Internal Revenue Code?

**A2** No. Generally only those U.S. domestic corporations that have 100 or fewer eligible shareholders and only one class of stock are considered a small business corporation eligible to make a subchapter S election. All other corporations are taxed under subchapter C of the Internal Revenue Code. Although the corporation must be a small business corporation under the Internal Revenue Code, the size of the corporation and the number of employees are not necessarily good indicators that a subchapter S election has been made.

**Q3** What is the difference between a subchapter C and a subchapter S corporation?

**A3** Both a subchapter C and a subchapter S corporation are corporations formed under state corporation laws. The only difference between a subchapter C and a subchapter S corporation is the subchapter of the Internal Revenue Code under which the corporation is taxed for federal income tax purposes. If the corporation is eligible to make an election to be taxed under subchapter S of the Internal Revenue Code and that election is made on a timely basis, then the corporation is taxed as a pass-through entity under subchapter S of the Internal Revenue Code. If the corporation does not or cannot make a subchapter S election, it is taxed under subchapter C of the Internal Revenue Code. If a corporation is taxed under subchapter C, the corporation's taxable income is subject to federal income tax and that corporate income is again taxed to its shareholders when any dividends are paid to the shareholders, a double taxation of the same income.

**Q4** How can I tell that a corporation has made a subchapter S election?

**A4** The legal name of the corporation will not disclose that the corporation has made a subchapter S election. Because subchapter S is a tax designation, not a legal status, you will have to ask whether or not a subchapter S election has been made by the corporation.

**Q5** Who are the owners of a subchapter S corporation?

**A5** The owners of a subchapter S corporation are the shareholders of the corporation. A subchapter S corporation is a corporation for all purposes other than tax purposes.

**Q6** Do the shareholders of a subchapter S corporation have to be individual persons?

**A6** No, the shareholders of a subchapter S corporation can be individual persons, estates, certain trusts, and certain exempt organizations. Partnerships and corporations cannot be shareholders of a subchapter S corporation.

### Compensation/Tax

**Q7** Why would an eligible corporation make a subchapter S election?

**A7** The primary reason an eligible corporation makes a subchapter S election is tax driven. A subchapter S corporation is a pass-through entity for federal income tax purposes and, as a result, the effect of making a subchapter S election is that the corporation's net income is not taxed at the corporate level, but is taxed only at the shareholder level.

**Q8** How are shareholders who are also employees of a subchapter S corporation compensated?

**A8** Shareholders who are also employees of the subchapter S corporation receive wages, salary, and other compensation reported on an IRS Form W-2 in the same manner as all other common law employees of the subchapter S corporation. Because the underlying business entity remains a corporation, employee/shareholders may also receive dividends from the corporation which are reported on IRS Form 1099-DIV. Employee/shareholders may also receive certain property distributions from the corporation which are reported by the subchapter S corporation on the Shareholder's Schedule K-1, Line 16 Code D, IRS Form 1120S.

**Q9 Is a subchapter S corporation a separate taxable entity?**

**A9** No. While a subchapter S corporation must file an annual IRS Form 1120S, there is no taxation at the corporate level on the net income of the subchapter S corporation. As stated above, a subchapter S corporation is a pass-through entity through which the income and expenses are “passed-through” to the shareholders. Each shareholder’s distributive share of the subchapter S corporation’s income and deductions are reported to the shareholder by the subchapter S corporation on the Shareholder’s Schedule K-1, Form 1120S. The subchapter S corporation shareholder is required to report those items on the individual shareholder’s IRS Form 1040 for the tax year.

**Q10 Are employee/shareholders of a subchapter S corporation eligible for tax-favored treatment under the employee benefit programs sponsored by the subchapter S corporation?**

**A10** Not necessarily. Those employee/shareholders who are deemed to own (directly and indirectly) more than 2% of the shares of stock of the subchapter S corporation are not treated as employees for fringe benefit purposes under the Internal Revenue Code. More than 2% shareholders are treated in the same manner as partners of a partnership are treated for fringe benefit purposes. See Partnerships. However, those employee/shareholders who are deemed to own (directly and indirectly) 2% or less of the shares of stock of the subchapter S corporation retain the same tax-advantaged treatment of the employee benefit programs sponsored by the subchapter S corporation as all of the other common law employees of the subchapter S corporation.

**Q11 Who is considered a more than 2% shareholder of a subchapter S corporation?**

**A11** An employee/shareholder is a more than 2% shareholder if the employee/shareholder directly in his/her own name owns more than 2% of the shares of the subchapter S corporation or owns shares of stock possessing more than 2% of the voting power of the subchapter S corporation. In addition, an employee/shareholder may be deemed to own more than 2% of the shares of stock in the subchapter S corporation by virtue of the attribution rules under I.R.C. §318 if certain family members of the employee/shareholder own shares of stock in the subchapter S corporation. An employee/shareholder is a more than 2% shareholder if the combined total of directly owned and indirectly owned stock (by virtue of the application of the attribution rules) exceeds 2%.

**Q12 Can employee/shareholders of a subchapter S corporation participate in a Section 125 plan that is sponsored by the subchapter S corporation?**

**A12** It depends. Those employee/shareholders who are deemed to own (directly and indirectly) 2% or less of the stock of the subchapter S corporation can participate in a Section 125 plan sponsored by the subchapter S corporation. However, those employee/shareholders who are deemed to own (directly and indirectly) more than 2% of the stock of the subchapter S corporation are not eligible to participate in the Section 125 plan sponsored by the subchapter S corporation.

## Group Insurance

**Q13 Can a group insurance policy be issued to a subchapter S corporation?**

**A13** Yes. A subchapter S corporation can be a policyholder of a group insurance policy covering the common law employees of the subchapter S corporation (including employee/shareholders who are deemed to own (directly and indirectly) more than 2% of the stock).

**Q14 If a subchapter S corporation purchases a group insurance policy to provide benefits to its employees, can all of the subchapter S corporation’s employee/shareholders be covered under that group insurance policy?**

**A14** State eligible group statutes allow a group insurance policy issued to a subchapter S corporation to cover the employee/shareholders as well as the employees of the subchapter S corporation. However, our underwriting rules generally require that shareholders can only be covered if they are at active work for the subchapter S corporation.

*Caution: Any shareholders who are not individuals will not be covered unless the shareholder is an associated company listed in the group insurance policy. See Associated Companies.*

**Q15 What compensation of an employee/shareholder will we take into account in determining weekly, monthly, and annual pay definitions?**

**A15** We will cover an employee/shareholder’s salary received from the subchapter S corporation plus property distributions other than dividends as reported by the subchapter S corporation on the Shareholder’s Schedule K-1, Line 16 Code D, IRS Form 1120S for the prior calendar year. See the *Subchapter S Corporations Section of Business Entities and Your Disability Contract* for additional information.

## Taxation of Premium & Benefits

### Employer-Paid Premium

Product	More than 2% Employee/Shareholder	Common Law Employees 2% or Less Employee/Shareholder
<b>Life</b>		
Premium	Taxable	Up to \$50,000 not taxable* Over \$50,000 taxable based on imputed income
Group Term Life Proceeds	Not taxable income to beneficiary	Not taxable income to beneficiary
Interest on Group Term Life Proceeds	Taxable	Taxable
<b>Disability</b>		
Premium	Taxable	Not Taxable
Disability Benefits	Not Taxable	Taxable
<b>Dental/Vision</b>		
Premium	Taxable	Not Taxable
Dental/Vision Benefits	Not Taxable	Not Taxable

\*If plan discriminatory under I.R.C. §79, premium is taxable to key employees.

# Professional Corporations/ Professional Associations

## General Information

**Q1** What is a professional corporation or professional association?

**A1** A professional corporation is a corporation formed by professionals for the purpose of rendering professional services. Licensed professionals can only incorporate by means of a professional corporation. State law will dictate how a professional association is formed. In some states, a professional association may be a corporation while in other states a professional association may be an unincorporated association. Whether the business entity is called a professional corporation or professional association depends on the state law where the professional corporation or professional association is formed.

**Q2** What is the legal name of a professional corporation or professional association?

**A2** The legal name of a professional corporation or professional association must include Professional Corporation, P.C., Professional Association, P.A. or some other designation as may be required by state law. For example, in Michigan, a professional corporation is called a service corporation and must include Service Corporation or S.C. in its legal name.

**Q3** Who are the owners of a professional corporation or professional association?

**A3** The owners of a professional corporation are the shareholders. The owners of a professional association may or may not be shareholders depending on state law. However, for both professional corporations and professional associations, only those persons licensed by the state to render services in a particular profession are eligible to be equity shareholders of a professional corporation or equity owners of a professional association. For example, the equity shareholders of a professional corporation formed for the purpose of rendering legal services must all be licensed attorneys.

**Q4** Do the shareholders of a professional corporation or owners of a professional association have to be individuals?

**A4** No. The shareholders of a professional corporation or owners of a professional association can be licensed individuals, other entities such as professional corporations, professional associations, or limited liability companies formed by the licensed professional, or a combination of individuals or other business entities formed by an individual licensed professional. See Associated Companies.

**Q5** Why do licensed professionals form professional corporations or professional associations?

**A5** Licensed professionals form professional corporations or professional associations in order to limit their personal liability for the debts and liabilities of the professional corporation or professional association and those of the other shareholders or owners. However, as to the acts of a shareholder or owner who is a licensed professional, that shareholder or owner is liable for any negligent or wrongful act or omission in which that shareholder or owner participates.

## Compensation/Tax

**Q6** How are the shareholders of a professional corporation or the owners of a professional association compensated?

**A6** It depends. The shareholder's or owner's compensation is likely described in the written shareholders' or owners' agreement. If some of the shareholders or owners are other business entities, the compensation paid to the licensed professional will depend on the type of business entity that is the actual shareholder or owner.

**Q7** Can individual shareholders of a professional corporation or the owners of a professional association receive an IRS Form W-2 from the professional corporation or professional association?

**A7** Yes. The compensation paid to individual shareholders of a professional corporation is reported on IRS Form W-2 regardless of whether the professional corporation is taxed under subchapter C or subchapter S of the Internal Revenue Code. If a professional association is treated as a corporation under state law and for federal income tax purposes, the shareholder/owner receives an IRS Form W-2 reporting the compensation paid to the shareholder/owner by the professional association. If the professional association is treated as a partnership for tax purposes, the partner/owner does not receive an IRS Form W-2 from the professional association.

**Q8** Is a professional corporation or professional association a separate taxable entity?

**A8** It depends. If the professional corporation or professional association is subject to tax under subchapter C of the Internal Revenue Code, it is a separate taxable entity and files an IRS Form 1120. If the professional corporation or professional association is eligible to and in fact makes a subchapter S election, the professional corporation or professional association is not a separate taxable entity but must file an annual IRS Form 1120S. If the professional association is treated as a partnership for federal income tax purposes, the professional association is not a separate taxable entity but must file an annual IRS Form 1065.

**Q9** Are the shareholders of a professional corporation or the owners of a professional association eligible for tax-favored treatment under the employee benefit programs sponsored by the professional corporation or professional association?

**A9** It depends. If the professional corporation or professional association is taxed under subchapter C of the Internal Revenue Code, the employee/shareholders are entitled to tax-favored treatment as employees of the professional corporation or professional association. However, if the professional corporation or professional association is taxed under subchapter S of the Internal Revenue Code, whether the shareholder is entitled to tax-favored treatment under the employee benefit programs depends upon whether the shareholder owns (directly or indirectly) more than 2% of the stock of the professional corporation or professional association. If the shareholder owns (directly and indirectly) 2% or less, the shareholder is entitled to the tax-favored treatment under the employee benefit plans. If the shareholder owns (directly and indirectly) more than 2% of the stock of the professional corporation or professional association, the shareholder is **not** eligible for tax-favored treatment under employee benefit plans and is treated as a partner for the fringe benefit purposes. If the professional association is treated as a partnership for federal income tax purposes, the partners are not eligible for tax-favored treatment under the employee benefit plans.

**Q10** Can a shareholder of a professional corporation or an owner of a professional association participate in a Section 125 plan that is sponsored by a professional corporation or professional association?

**A10** It depends. If the professional corporation or professional association is taxed under subchapter C, the employee/shareholders are eligible to participate in the employer-sponsored Section 125 plan. If the professional corporation or professional association has made a subchapter S election, those employee/shareholders who are deemed to own (directly and indirectly) 2% or less of the stock of the professional corporation or professional association can participate in the Section 125 plan sponsored by the professional corporation or professional association. However, those employee/shareholders who are deemed to own (directly and indirectly) more than 2% of the stock of the professional corporation or professional association are **not** eligible to participate in the Section 125 plan sponsored by the professional corporation or professional association. If the professional association is treated as a partnership for federal income tax purposes, the partners are **not** eligible to participate in the Section 125 plan sponsored by the professional association.

## Group Insurance

**Q11** Can a group insurance policy be issued to a professional corporation or professional association?

**A11** Yes. A professional corporation or professional association can be a policyholder of a group insurance policy covering the common law employees of the professional corporation or professional association.

**Q12** If a professional corporation or professional association purchases a group insurance policy to provide benefits to its employees, can the shareholders or owners be covered under that group insurance policy?

**A12** Yes. State eligible group statutes allow a group insurance policy issued to a professional corporation or professional association to cover the shareholders or owners as well as the employees of the professional corporation or professional association. However, our underwriting rules generally require that the shareholders or owners can only be covered if they are at active work for the professional corporation or professional association.

*Caution: Any shareholders or owners who are not individuals will not be covered unless the shareholder or owner is an associated company listed in the group insurance policy. For example, a shareholder in a professional corporation is another professional corporation. The shareholder of that professional corporation will not be covered under the group insurance policy unless that professional corporation is listed as an associated company in the group insurance policy. See Associated Companies.*

**Q13** What compensation of an employee/shareholder or owner will we take into account in determining weekly, monthly, and annual pay definitions?

**A13** It depends. If the professional corporation is taxed under subchapter C of the Internal Revenue Code, see *Corporations*. If the professional corporation or professional association has made a subchapter S election, see *Subchapter S Corporations*. If the professional association is taxed as a partnership, see *Partnerships*. See the *Professional Corporations/Professional Associations* section of *Business Entities and Your Disability Contract* for additional information.

## Taxation of Premium & Benefits

### Employer-Paid Premium

Product	More than 2% Employee/Shareholder	Partner/Owner of Professional Association	Common Law Employee 2% or Less Employee/Shareholder Subchapter S Corporation
<b>Life</b>			
Premium	Taxable	Taxable	Up to \$50,000 not taxable* Over \$50,000 taxable based on imputed income
Group Term Life Proceeds	Not taxable to beneficiary	Not taxable to beneficiary	Not taxable to beneficiary
Interest on Group Term Life Proceeds	Taxable	Taxable	Taxable
<b>Disability</b>			
Premium	Taxable	Taxable	Not Taxable
Disability Benefits	Not Taxable	Not Taxable	Taxable
<b>Dental/Vision</b>			
Premium	Taxable	Taxable	Not Taxable
Dental/Vision Benefits	Not Taxable	Not Taxable	Not Taxable

\*If plan discriminatory under I.R.C. §79, premium is taxable to key employees.

# Limited Liability Companies

## General Information

Q1 What is a limited liability company?

A1 A limited liability company (LLC) is an unincorporated business entity recognized in the United States in all 50 states and the District of Columbia as a legal means of doing business. An LLC is a separate type of legal entity.

Q2 What is the legal name of a limited liability company?

A2 The legal name of a limited liability company must include one of the following: Limited Liability Company, LLC, LC, Ltd., or Limited. Some state laws distinguish a limited liability company formed by professionals by requiring the legal name to include one of the following: Professional Limited Liability Company, PLC, or PLLC.

Q3 How is a limited liability company formed?

A3 A limited liability company is a creature of state law and must be formed and operated in accordance with state law. A formal filing with the secretary of state where the LLC is formed is required. State law may also prohibit certain professionals from operating as a limited liability company. For example, California law does not allow lawyers to practice law by means of a limited liability company.

Q4 Who are the owners of a limited liability company?

A4 The owners of a limited liability company are called members.

Q5 Is there a required number of members a limited liability company must have?

A5 No. A limited liability company can be formed by one or more individuals, other types of business entities, or a combination of both.

Q6 Why would a business choose to operate as a limited liability company?

A6 Limited liability companies are an attractive means of doing business because a limited liability company combines the best attributes of doing business as a corporation and as a partnership.

Q7 What corporation attributes does a limited liability company have?

A7 The primary advantage of doing business as a corporation is the limited liability provided to the shareholders. Since a corporation is a separate legal entity, only the corporation, not the shareholders, is liable for the obligations, debts, and liabilities of the corporation. The shareholder's risk is limited to the value of the shareholder's stock investment. A limited liability company offers the same type of liability shield to its members because a limited liability company is a separate legal entity. As such the limited liability company, not the members, is liable for the obligations, debts, and liabilities of the limited liability company. However, for professional limited liability companies (PLLC) the liability shield applies to the obligations, debts, and liabilities of the PLLC and the acts of the other members of the PLLC, but not to the acts and malpractice of the member. Members of a PLLC cannot escape liability from their own acts and malpractice by forming a PLLC.

Q8 What partnership attributes does a limited liability company have?

A8 The two primary advantages of doing business as a partnership are active participation by the partners in the management and operation of the partnership and the "pass-through" tax treatment afforded partnerships. A limited liability company has these same attributes. Each member of a member-managed limited liability company has a right to actively participate in the management and operation of the limited liability company. Because of the IRS' "check-the-box" rules, limited liability companies can choose how they want to be treated for tax purposes. Limited liability companies generally choose to be treated as pass-through entities for tax purposes.

Q9 Does a limited liability company have to be member-managed?

A9 No. A limited liability company can be member-managed or manager-managed. If the members elect to have the limited liability company manager-managed, the limited liability company will engage a manager to manage and operate the limited liability company in accordance with a written operating agreement signed by both the manager and the limited liability company.

Q10 Are there any disadvantages of doing business as a limited liability company?

A10 One potential disadvantage for members of a limited liability company is that, depending on state law, members may not be able to freely transfer their ownership interest in the limited liability company to other members or third parties without the approval of the other members.

## Compensation/Tax

Q11 How are the members of a limited liability company compensated?

A11 Generally, the members of a limited liability company have entered into a written agreement that sets forth how and when members are compensated. How the members of a limited liability company are compensated may also depend upon how the limited liability company has elected to be treated for tax purposes under the “check-the-box” rules. If the limited liability company has elected to be treated as a partnership for tax purposes, the members may agree upon a draw and periodic “true-up” arrangement. If the limited liability company has elected to be treated as a corporation for tax purposes, and has made a subchapter S election, the members could receive regular salary plus periodic property distributions. If the limited liability company is a single member limited liability company, the limited liability company is treated as a disregarded entity in the same manner as a sole proprietorship is a disregarded entity for tax purposes.

Q12 Do the members of a limited liability company receive an IRS form W-2 from the limited liability company?

A12 It depends. If the limited liability company has elected to be treated as a corporation for tax purposes, regardless of whether a subchapter S election has been made, the members could receive an IRS Form W-2 from the limited liability company. If the limited liability company is a single member limited liability company or if it has elected to be treated as a partnership for tax purposes, the members will not receive an IRS Form W-2 from the limited liability company. The members in this latter instance will not be treated as employees of the limited liability company but will be treated as self-employed individuals subject to self-employment taxes.

Q13 How are a member’s earnings from self-employment determined?

A13 For limited liability companies that are treated as partnerships for tax purposes, a member’s earnings from self-employment are determined in the same manner as a partner of a partnership; that is, the sum of the member’s distributive share of net income (ordinary income) plus guaranteed payments from the limited liability company both as reported on the Partner’s Schedule K-1, IRS Form 1065. For limited liability companies that are treated as sole proprietorships (disregarded entities), a member’s earnings from self-employment is the net income from the limited liability company as adjusted on IRS Form SE (Form 1040).

Q14 Is a limited liability company a separate taxable entity?

A14 It depends on how the limited liability company has elected to be treated for federal income tax purposes. Only if the limited liability company has elected to be treated as a corporation and subject to tax under subchapter C of the Internal Revenue Code will the limited liability company be a separate taxable entity. If the limited liability company makes a subchapter S election or is treated as a partnership for tax purposes, the limited liability company has the same annual tax reporting obligations of a subchapter S corporation or a partnership.

Q15 Are the members of a limited liability company eligible for the tax-favored treatment under the employee benefit programs sponsored by the limited liability company?

A15 It depends upon how the limited liability company has elected to be treated for tax purposes. There are only two instances under which the members of a limited liability company are eligible for the tax-favored treatment under the employee benefits programs sponsored by the limited liability company. First, if the limited liability company has elected to be treated as a corporation and taxed under subchapter C of the Internal Revenue Code, the members will be treated in the same manner as employees in terms of the taxability of the employee benefit programs. Second, if the limited liability company has elected to be treated as a corporation and has made a subchapter S election, those members owning (directly and indirectly) 2% or less ownership interest in the limited liability company will be treated as employees and are eligible for tax-favored treatment under the employee benefit programs sponsored by the limited liability company. Those members who own (directly and indirectly) more than 2% ownership interest in a limited liability company that is taxed as a subchapter S corporation are **not** eligible for tax-favored treatment under those employee benefit plans. If the limited liability company is treated as either a partnership or a disregarded entity for tax purposes, the members are **not** eligible for the tax-favored treatment available to employees participating in the employee benefit programs sponsored by the limited liability company.

Q16 Can members of a limited liability company participate in a Section 125 plan that is sponsored by the limited liability company?

A16 It depends upon how the limited liability company has elected to be treated for tax purposes. As stated above, only those members of a limited liability company that has elected to be taxed as a subchapter C corporation and those members who own (directly and indirectly) 2% or less of a limited liability company that has made a subchapter S election are treated as employees and thereby are eligible to participate in a Section 125 plan sponsored by the limited liability company. Those members owning (directly and indirectly) more than 2% of the limited liability company that has made a subchapter S election are **not** eligible to participate in the limited liability company's Section 125 plan. If the limited liability company has elected to be treated as a partnership or a disregarded entity for tax purposes, the members **cannot** participate in a Section 125 plan sponsored by the limited liability company.

## Group Insurance

Q17 Can a group insurance policy be issued to a limited liability company?

A17 Yes. A limited liability company can be a policyholder of a group insurance policy covering the common law employees of the limited liability company.

Q18 If a limited liability company purchases a group insurance policy to provide benefits to its employees, can the members be covered under that group insurance policy?

A18 The members of a limited liability company can be covered under a group insurance policy in the same manner as partners of a partnership or shareholders of a corporation can be covered under a group insurance policy. However, our underwriting rules generally require that the members can only be covered if they are at active work for the limited liability company.

*Caution: Any members that are not individuals will not be covered unless the members are associated companies listed in the group policy. For example, if a member is another limited liability company, the member(s) of that limited liability company are not covered persons under the group insurance policy unless that limited liability company is listed as an associated company in the group insurance policy.*

Q19 What compensation of a member will we take into account in determining weekly, monthly and annual pay definitions?

A19 It depends upon how the limited liability company has elected to be treated for tax purposes. If the limited liability company is treated as a subchapter C corporation for tax purposes, *see Corporations*. If the limited liability company has made a subchapter S election, *see Subchapter S Corporations*. If the limited liability company is treated as a partnership for tax purposes, *see Partnerships*. If the limited liability company is a disregarded entity, *see Sole Proprietorships*. *See the Limited Liability Companies section of Business Entities and Your Disability Contract* for additional information.

## Taxation of Premium & Benefits

### Employer-Paid Premium

Product	Members who are treated as more than 2% shareholders of subchapter S corporation, partners, sole proprietors	Common law employee members who are treated as 2% or less shareholders of subchapter S corporation or employee of subchapter C corporation
<b>Life</b>		
Premium	Taxable	Up to \$50,000 not taxable* Over \$50,000 taxable based on imputed income
Group Term Life Proceeds	Not taxable to beneficiary	Not taxable to beneficiary
Interest on Group Term Life Proceeds	Taxable	Taxable
<b>Disability</b>		
Premium	Taxable	Not Taxable
Disability Benefits	Not Taxable	Taxable
<b>Dental/Vision</b>		
Premium	Taxable	Not Taxable
Dental/Vision Benefits	Not Taxable	Not Taxable

\*If plan discriminatory under I.R.C. §79, premium is taxable to key employees.

## Associated Companies

### General Information

Q1 What is an associated company?

A1 For the purpose of these materials, associated company means a separate legal entity whose business is under the common control of or with the business of a policyholder.

Q2 Is a division of a group policyholder an associated company?

A2 No. A division within a policyholder's business that is not a separate legal entity is not an associated company. For example, the group policyholder is Building Supply, Inc. Building Supply, Inc. has a lumber division. The lumber division is part of Building Supply, Inc. Because it is not a separate legal entity, the lumber division is not an associated company. However, if instead, the lumber division is called Lumber Suppliers, Inc., a separate legal entity, Lumber Suppliers, Inc. could be an associated company of Building Supply, Inc.

Q3 When does an insurance carrier need to know if a policyholder has associated companies?

A3 A group insurance carrier needs to know if a policyholder has associated companies if the owners and/or employees of the associated company(ies) are intended to be covered under the group insurance policy issued to a policyholder. Failure to specifically include an associated company within the group insurance policy may result in no coverage for the owners and/or employees of the associated company(ies).

Q4 What entities could be considered to be associated companies of a policyholder?

A4 The state eligible group statutes in most states provide guidance as to what types of entities can be considered associated companies for group insurance purposes. Those statutes describe associated companies in terms of the employees who can be covered under a group insurance policy issued to a policyholder. Employees of one or more subsidiary corporations, one or more affiliated corporations, one or more proprietorships, one or more partnerships or any combination of these entities can be covered under the group insurance policy issued to an employer policyholder **so long** as the business of the policyholder and the business of the subsidiary corporations, affiliated corporations, sole proprietorships, or partnerships is under common control through stock ownership, contract, or otherwise.

Q5 If a group policyholder is a corporation that owns 100% of the stock of Y Corporation, could Y Corporation's employees be covered as an associated company under the group insurance policy issued to the policyholder?

A5 Yes. Y Corporation is a subsidiary corporation of the policyholder. Common control is established through stock ownership because the policyholder owns 100% of the stock of Y Corporation. The employees of Y Corporation could be covered under the group insurance policy issued to the policyholder if Y Corporation is listed as an associated company on the policy.

Q6 Could Y Corporation be considered an associated company in the above example if the corporate policyholder owns only 51% of the stock of Y Corporation?

A6 Yes. In order to be a subsidiary corporation, the corporation policyholder must own a majority of the shares of stock in the subsidiary corporation, that is, 51% or more. Because the corporation policyholder owns 51% of the stock of the Y Corporation, the required common control exists and Y Corporation could be an associated company.

Q7 What if the corporate policyholder owns 40% of the stock of Y Corporation, can the employees of Y Corporation be covered under the group insurance policy issued to the policyholder?

A7 It depends. If the policyholder, which is a corporation, owns a majority of Y Corporation's stock, the employees of Y corporation could be covered under the group insurance policy issued to the policyholder. Majority ownership of Y Corporation's stock could be less than 51% ownership. For example, if the stock of Y corporation is owned 40% by the policyholder, 20% by Z Corporation, 35% by Mrs. Smith and 5% by Mr. Doe, the policyholder owns the highest percentage of Y Corporation's stock and is the majority owner. Y Corporation is considered an affiliated corporation of the policyholder. The result would be different if, instead of owning 40% of the stock of Y Corporation, the policyholder owned 5% of Y Corporation's stock and Z Corporation owned 55% of Y Corporation's stock. In that situation, Y Corporation is an affiliate of Z Corporation so the employees of Y Corporation could not be covered under a group insurance policy issued to the policyholder.

Q8 Can the owners of a business entity that are not individual persons be considered an associated company of that business entity?

A8 Yes, provided common control exists. For example, the policyholder is a professional corporation, Smith, White and Brown, P.C. The shareholders of Smith, White and Brown, P.C. are William Smith, P.C., Bruce White, P.C., and Walter Brown, P.C. In this example the business of Smith, White and Brown, P.C. and the business of William Smith, P.C., Bruce White, P.C., and Walter Brown, P.C. are under common control through stock ownership because William Smith, P.C., Bruce White, P.C., and Walter Brown, P.C. together own all of the stock of Smith, White, and Brown, P.C. Because Smith, White and Brown, P.C. is a professional corporation, it is likely that there is also common control by contract through a shareholder agreement between Smith, White and Brown, P.C. and William Smith, P.C., Bruce White, P.C., and Walter Brown, P.C.

Q9 If the group insurance policy issued to Smith, White and Brown, P.C. covers the shareholders and employees of Smith, White and Brown, P.C., will William Smith, Bruce White, and Walter Brown be covered under that group insurance policy?

A9 No. The shareholders of Smith, White, and Brown, P.C. are William Smith, P.C., Bruce White, P.C., and Walter Brown, P.C. In order for William Smith, Bruce White and Walter Brown to be covered under the group insurance policy, each of their individual professional corporations should be included as associated companies. William Smith, Bruce White and Walter Brown each would be covered as a shareholder of his professional corporation.

Q10 Are there certain types of business entities where the owners are more likely to be other business entities?

A10 Yes. The owners of a professional corporation or a professional association, and professionals conducting business by means of a partnership, limited liability partnership, or limited liability company could be another business entity rather than an individual person. The owners of these types of business entities may be another business entity to further shield the individual owners of those other business entities from liability. Depending on the type of business entity there may also be some tax advantages provided by creating these types of multilayered organizations.

Q11 Can common control be established if two corporations have the same persons on their respective board of directors?

A11 No. The members of the board of directors of each entity owe a fiduciary duty to the corporation on whose board of directors he or she serves. Common members on the two corporations' board of directors does not establish common control of the business of the two corporations.

## BUSINESS ENTITY DEFINED TERMS

**Active Work:** A defined term in the group insurance policy. We define “active work” as the expenditure of time and energy by a person for a policyholder or an associated company at that person’s usual place of business on a full-time basis.

**Affiliated Corporation:** A corporation that is controlled by another corporation (includes a parent and subsidiary). Control in this context means that one corporation owns the majority of the stock of another corporation. Majority stock ownership can be less than 50%.

**Associated Company:** A group policy term that is used to cover other business entities that are under common control with the policyholder.

**Business Entity:** A legal entity recognized under case law or statutes as a lawful means of conducting business. Examples of business entities include sole proprietorships, partnerships, corporations, and limited liability companies. A business entity is **not** a type of business in a particular industry (for example, a manufacturing company or law firm).

**Common Control:** State eligible group statutes determine common control requirements for a particular state. Generally, common control can be established by stock ownership (i.e., see Affiliated Corporation, Subsidiary Corporation), contract, or by other means.

**Common Law Employee:** A legal status based upon a worker’s employment by a common law employer.

**Common Law Employer:** A legal status based upon the rights to direct and control the manner and means with which work is performed by common law employees based on all the relevant facts and circumstances.

**Continuity of Existence:** Continuity of Existence concerns whether the business entity can continue to exist when the owner dies, files for bankruptcy, or leaves the business. In other words, does the business entity continue to exist on its own or is it automatically dissolved because the owner is no longer associated with the business entity.

**Corporation:** An incorporated business entity that is formed by filing articles of incorporation with the secretary of state under the state’s corporation statutes.

**Draw:** Draw represents amounts withdrawn by or distributed to an owner of a business entity that are not reported on IRS Form W-2. For example, a partner of a partnership may be entitled to a monthly draw which represents an expected amount of income to be earned over a period of time. There may be a periodic “true up” of draw taken and income earned resulting in either repayments to the partnership or additional amounts distributed to the partner depending on the actual income for the period “trued-up.”

**Eligible Group Laws:** The state insurance laws that specify the types of groups to which a group insurance policy can be issued and those persons who can be covered under that group insurance policy.

**Employee:** An employee is a common law employee who receives an IRS Form W-2 from his/her employer.

**Employer:** An entity that has common law employees.

**ERISA:** Employee Retirement Income Security Act of 1974, as amended.

**Form 1099-MISC:** An IRS information reporting form that is filed with the IRS by various payors to report nonemployee compensation and other types of income paid to independent contractors (1099 workers). Form 1099-MISC reports the amount paid, the payee’s name, address and taxpayer identification number, as well as payor’s name and taxpayer identification number.

**Form W-2 Earnings:** Wages, salary and other compensation paid by an employer to a common law employee that is reported by the employer in box 1 of IRS Form W-2.

**Full-Time:** A defined term in the group insurance policy. Generally, we define “full-time” as working at least 30 hours per week for employer-paid premium policies and 20 hours per week for employee-paid premium policies.

**Independent Contractor:** An individual who operates his/her own business and controls the means and methods of performing the work of that business. Also known as a 1099 worker.

**Joint and Several Liability:** Partners of a partnership and the general partners of a limited partnership are jointly and severally liable for the debts and liabilities of the partnership or limited partnership. The term “joint and several” means a creditor of the partnership or limited partnership may sue one or more partners either separately or together. As a result, one partner may be sued for and required to pay the entire debt or liability. That partner then may seek contribution from the other partners of the partnership or general partners of a limited partnership.

**K-1 Earnings:** K-1 earnings refer to amounts of income and expense items “passed through” to the owners of certain types of pass-through entities and reported on an IRS Schedule K-1. For purposes of a partnership, Schedule K-1 means the Partner’s Schedule K-1, Form 1065 that a partner receives from the partnership. For shareholders of a subchapter S corporation, Schedule K-1 means the Shareholder’s Schedule K-1, Form 1120S that a shareholder receives from the subchapter S corporation.

**Limited Liability:** Limited liability refers to who is ultimately responsible for the debts and liabilities of the business entity. Are the owners of a business entity liable for those debts and liabilities or is the business entity solely liable, thereby protecting the individual assets of the owners?

**Limited Liability Company:** An unincorporated business entity that is formed through a filing with the secretary of state under the state’s limited liability company statutes.

**Management and Control:** Management and control concerns whether the owners of a business entity have the right to manage and control the day-to-day business operations of the entity.

**Member:** A member is the owner of a limited liability company.

**Manager Managed:** Describes how a limited liability company is managed. A limited liability company can be member managed or manager managed. If manager managed, the members enter into an operating agreement with the manager to manage the limited liability company. The operating agreement sets the parameters of the manager’s duties and responsibilities.

**Ordinary Income:** Ordinary income is a tax number and generally represents the net profit of a pass-through entity.

**Owner:** See *Business Entities Chart - Key Characteristics*.

**Partner:** A partner is one of two or more owners of a partnership. A partner can be a general partner or a limited partner. Status as a general or limited partner will control the partner’s participation in the management of the partnership and the partner’s personal liability for partnership debts.

**Pass-Through Entity:** Tax term to describe a business entity whose net income is not taxed at the business entity level but that net income is “passed-through” to the owners of that business entity and subject to tax at the owner level. Sole proprietorships, partnerships, subchapter S corporations, and limited liability companies are pass-through entities.

**Professional Corporation / Professional Association:** These types of business entities can only be formed by licensed professionals in the same profession. These business entities are creatures of state law so state law will specify whether the business entity is called a professional corporation or professional association and how these business entities can be formed. In Michigan, a service corporation is the term used in Michigan statutes to describe a professional corporation.

**Salary:** The amounts paid as compensation for services rendered. Salary is reported by an employer to an employee on IRS Form W-2, box 1 (wages, tips, and other compensation).

**Secretary of State:** The state official to whose office any documents are filed for formal approval and recognition of a business entity when formal filing is required.

**Self-Employment Taxes:** Taxes imposed on persons who are self-employed. Self-employed persons are not employed by an employer so self-employed persons are responsible for 100% of the Self-Employment Taxes. Self-Employment Taxes are reported on Schedule SE which is filed with the self-employed person's IRS Form 1040. Self-employed persons can include independent contractors, sole proprietors, general partners, and certain members of a limited liability company.

**Shareholder:** A shareholder is a person or entity that owns 1 or more shares of stock of a corporation.

**Sole Proprietor:** The single owner of a sole proprietorship. The sole proprietorship cannot exist independently of the sole proprietor because the sole proprietor and the sole proprietorship are considered one in the same person.

**Subchapter C Corporation:** A corporation that is taxed under subchapter C of the Internal Revenue Code because it has not made, or is not eligible to make, a subchapter S election. Subchapter C applies to a corporation for federal income tax purposes unless the corporation has made a valid subchapter S election.

**Subchapter S Corporation:** A corporation that has made a tax election to be treated as a pass-through entity under subchapter S of the Internal Revenue Code. Only certain corporations are eligible to make a subchapter S election.

**Subsidiary Corporation:** A corporation whose stock is more than 50% owned by another corporation. This relationship is commonly referred to as a parent and subsidiary.

**Tax-Favored Treatment:** Generally refers to those employer-provided benefits that are treated as non-taxable to the employee under the Internal Revenue Code.

**Transferability of Interest:** Transferability of interest concerns whether the owners of a business entity can freely transfer their interest in the business entity by sale, gift or by some other type of transfer to third parties without consent of the other owners of the business entity.





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