

1. Selecting a Business Entity

You may wish to consult your accountant or attorney regarding the business entity that best suits your circumstances, such as sole proprietorship, partnership or corporation or Limited Liability Company. If forming a corporation, you will want to determine whether a Sub Chapter-S Corporation may be to your advantage.

Let's briefly discuss the difference between the various business entities.

The Sole Proprietorship

- Essentially, a sole proprietorship is an open business using a "fictitious name" (such as "Earl's Home" or "Funny Finders" or "Your Name Here Cleaning Service", etc.) It's a popular business format because it's easy and inexpensive to start.
- Other than routine legal and accounting services required for your business activities, neither legal or accounting assistance is required to start, terminate, modify or modify your business. You can decide to start a business and immediately say "I'm open for business" or you can file a "Doing Business As" (DBA) form.
- However, the sole proprietorship is not a separate person and business affairs are considered an extension of the proprietorship. A sole proprietorship has a lack of limited liability protection from the lack of a separate business entity. Your personal assets and your family own is at risk in both the business and personal activities. Business income is treated as personal income and is subject to state and federal income tax and, if applicable, self-employment tax.

Tax treatment of sole proprietorships is typical of small businesses can be used where applicable. Examples include: write-off of the business portion of the costs of vehicle depreciation and lease payments for vehicles used for both business and personal purposes, deductibility of business travel costs, and direct business expenses on Schedule C of Form 1040

The Partnership

- A partnership is an association of two or more persons formed to carry on a business. As such, it is a special form of business entity separate from the individuals (partners) and is owned by two or more persons each of whom has a specified ownership interest.

Selecting a Business Entity

- All partnerships should be based on a written partnership agreement. While many partnership agreements are informal, the lack of a written agreement can result in extremely damaging conflicts between partners when a disagreement arises.
- All profits and losses pass through to the partners' individual tax returns in proportion to their respective ownership interests. Unless continuity of the partnership is provided for in the partnership agreement, a partnership is dissolved upon the death or withdrawal of one of the partners. Borrowing for the partnership and the loan documentation signed under a personal guarantee by partners and their respective spouses (if any).
- Partnerships are an easy way of combining the financial and physical resources to make it easier to establish and continue a business. When all partners contribute assets, the borrowing capacity of a partnership may be greater than the total borrowing capacity of the partners as individuals.
- Partnerships have some advantages and some serious disadvantages. One thing to think about with a minority interest in the business is that you or another partner may have the operation of the business. Disagreements or conflicts among partners can result in a deadlock. Understanding the financial standing of each partner or disagreements among the partners can result in a deadlock or a loss of productivity.
- A well-drafted partnership agreement can reduce or avoid many of the potential problems. However, a partnership agreement cannot eliminate the potential liabilities that accompany being partner as there are many state and court decisions.
- Partnership income, including capital gains, pass through to the partners on their respective partnership interests and is taxed to the partners as if they were individual taxpayers. Partnership income is subject to both state and federal income tax and, as applicable, to self-employment taxes. Cash wages paid to partnership employees are also subject to payroll taxes in the same manner as is the case for employees in any other type of economic activity.

The S Corporation

- An "S Corporation" is a corporation that elects to be taxed under Subchapter S of the Internal Revenue Code and receives IRS approval of its request for Subchapter S status. As a legal entity (an artificial person), the S corporation is separate and distinct from the

Selecting a Business Entity

corporation's owner or owners (which would be you and anyone else, such as your spouse, who may be involved in the operation of the business with you).

- As a separate legal entity, the corporation finances and records are established and maintained completely separate and distinct from the finances and records of the stockholders. Credit payments are made in the name of the corporation with loan documents signed by the authorized person or persons. If the corporation is newly formed or has a limited record of credit use, it's likely that lenders will require personal guarantees by one or more of the owners. When approving a credit application on behalf of a corporation, a personal guarantee is given, you personally have the liability for the debts of the corporation.
- Moderate legal costs are incurred to set up a C corporation and annual costs are incurred for tax and reporting. Public notice of the formation and filing of the corporation is required and is accomplished by filing with the State's Office in your state.
- Creation of the corporation should take into account the absence of personal guarantees on loans. You should consider your investment in the corporation and the risks you are taking in advance of forming an S corporation.
- With only a single owner, you can elect S chapter S election for the corporation. The S election allows you to pay taxes and corporate income taxes on the corporation's income. If you have other income from a wage or salary, you may file a joint income tax return with your spouse and you may deduct any losses from your S corporation against your other income. This can reduce your personal income tax accordingly.

The "C" Corporation

As a legal entity (an artificial person), the C corporation is separate and distinct from you – the owner of the corporation. As a tax-paying entity, the C corporation must pay taxes on its taxable income prior to making dividend distributions to stockholders, and the dividends are taxed to the stockholders resulting in double taxation of corporation income. This is the most frequently cited disadvantage of the C Corporation. However, the effects of this double taxation can be reduced when you derive most of your income from wages (which are tax deductible to the corporation) rather than as dividends.

Selecting a Business Entity

- Unlike the S Corporation, losses incurred in a C corporation cannot be written off against other income you may derive from other sources.
- C corporations pay income tax at rates that, depending on their level of taxable income, can be more or less than the income tax rates of single or married stockholders with comparable levels of taxable income. If you are considering forming a C corporation, secure current information on the relevant tax rates and compare estimated tax costs with and without incorporation before deciding to incorporate your business.
- As with an S Corporation, in the absence of personal guarantees, the structure limits your personal liability for capital investments in the corporation. In either form of incorporation, to the extent the corporate shield is maintained, your personal investments and savings in the corporation are not at risk, and your personal liability is limited.

The "Limited Liability Company"

- The Limited Liability Company (LLC) is a recognized business structure in all 50 states and the District of Columbia. LLCs are gaining popularity among small business owners because they combine the advantages of corporations with the tax advantages and management flexibility of partnerships.

- The main advantages of LLCs over corporations are:

- LLCs are formed with less cost and by simple filing
- LLCs provide personal liability protection from your business liabilities
- LLCs have fewer ownership restrictions

- The main differences between LLCs and corporations are:

- Corporations issue stock and are owned via stock. LLCs do not issue stock. Like partnerships, LLCs are simply owned by the members or the managers of the company.
- Corporations are required to hold annual meetings and to keep minutes. LLCs do not have this requirement, resulting in less official paperwork.

Corporations are taxable entities, and (except for Subchapter S corporations) they must pay taxes on their profits at the corporate tax rate. LLCs, like sole proprietors, partnerships and S Corporations, are "pass-through" tax entities. This means that

the profit or loss generated by the business is reflected on the personal income tax return of the owners, thus avoiding the double taxation of paying first corporate tax on profits and then personal income tax on distributions of profits.

- Because of their flexibility and relative simplicity, they are well suited for both start-up businesses and more mature businesses. LLCs have been gaining speed in recent years. In fact, new LLC formations now out-number new corporation formations in several states. LLCs have certain “ease of use” advantages.
 - LLCs provide greater management flexibility than corporations. For instance, corporations are required to have a formal structure with directors and officers. LLCs can be simply run by the members or managers.
 - LLCs provide greater flexibility regarding the distribution of profits than do corporations. In corporations, dividends are distributed evenly to all shareholders. In LLCs, profits can be distributed as desired.

Protect Your Assets

- Whether you are starting a new business or it is very important to protect your personal assets and your family's wealth. It can be formed for you in any state with no residency requirements. The good news is — as the needs of your business change, your business structure can be changed. LLCs can be formed quickly, easily and inexpensively.

- Many clients start as a sole proprietorship and then form a corporation at a later date. In fact, many small business owners never do form a corporation. They are not in a position to give you the advice best suited for their personal, like your attorney or accountant. This is why we usually provide you with a general overview and to get you thinking about the type of business entity you will form. If you're currently a sole proprietor or partnership, you may want to talk to your advisor about forming a Limited Liability Company or LLC.

Starting a Business as a DBA

- Assuming you're going to start your business as a sole proprietorship or partnership, you'll need to register under the “Fictitious Name Act”.

Selecting a Business Entity

Anytime you're doing business in a name other than your own you are required to get a "DBA" (which stands for *Doing Business As*).

- **A DBA performs 2 basic functions for your Business:**
 - 1) Provides you with the **Legal Vehicle to do Business** (in the name of your Business) such as, opening a bank account, and
 - 2) It gives you the exclusive use of the name for your business for 5 years, which you can renew every 5 years. Filing another DBA under your Business Name again to Renew it in your Area.
- **When you plan to start your business, you need to get a (Fictitious Name Statement) to open a Business Bank Account.**
 - If you have a corporation, you do not need to get a DBA to open your bank account. If you open a corporate bank account with your corporation of incorporation, you may want to consider getting a DBA to use your corporate name in your area for a year period. If you are not a corporation, you can use your business name.

- **To get a DBA for your business, what is relatively easy to do, you need to do the following:**

1) Set up your business name.

NOTE:

WorkEnders, Inc. is a registered trademark of WorkEnders, Inc. And it shows "are all trademarks of WorkEnders, Inc. You may use any other name for your business, it's a good idea to run a trademark search on the name you want to use to prevent lawsuits which may be filed against you for trademark infringement.

2) Determine the legal format of your business:

(a) Sole proprietorship

(b) Partnership

- **Then you need to go to the recorders office location is in your area, which is responsible for DBAs. This may be your City Hall, County Recorder's Office, County Tax Collector's Office or your local courthouse.**

➢ At the County Recorders Office you will be asked to fill out a form for a fictitious name statement. On the Form, you will be required to provide the specific legal format of your Business:

- a) an individual, sole proprietorship
- b) co-partners
- c) a general partnership
- d) husband and wife, a sole proprietorship of 2 people

- e) a corporation
- f) a limited liability company (LLC)

- **The cost to file your DBA is about \$10.00 in most of the U.S. But then you must also publish your DBA for 4 consecutive weeks in a local newspaper in order for the DBA to become legally registered in that county.**

You publish your DBA yourself for 4 consecutive weeks, or you can use a publishing service usually available at the County Office where you file. The cost to publish this way runs around \$30.00 to \$50.00.

When you're ready to Incorporate

- When you're ready to incorporate, you transfer the assets of your sole proprietorship or partnership to the corporation. Of course, you may also elect to form a Corporation on the very get-go. We reiterate that it's best to consult with an attorney to determine what's best for you.
- State filing fees for an LLC range from a low of \$40 in Oregon up to as much as \$500 in Rhode Island for either an S or C Corporation. In Texas, the filing fee for a corporation is as high as \$325 in Texas.
- If your attorney handles the incorporation, you will also incur additional fees for your attorney's filing fees. This cost could range from \$500 to \$1,000 or more. However, there are a number of companies that offer to supply the incorporation forms on your behalf, often for a flat fee.