Financial, Legal & Tax Advisory

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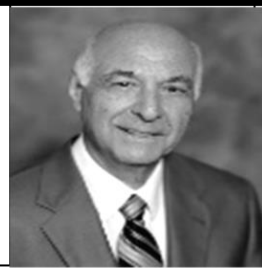

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Business Structures: Which One is Right for You?

With the year ending, it is time for everyone to prepare for the upcoming tax season. This season, especially for business owners, can be very stressful. Many business owners may be on edge when considering the possibility of footing a large tax bill. The best way to plan for taxes as a business owner starts initially. When starting your small business, your choice of business structure plays a vital role in minimizing taxes and reducing personal liability. Starting with the most common and simple business structure, a sole proprietorship owns an unincorporated business by himself or herself. A key advantage to operating as a sole proprietorship is simplicity.

Within this business structure, there is no distinction between the business and the individual who owns it, leaving the owner entitled to all profits. Along with this, your business assets and liabilities are not separated from personal ones, leaving the business owner personally held liable for the debts and obligations of the business. The owner will report all income and expenses on their tax return (Form 1040) using a Schedule C and pay taxes on any profit. Moving onto partnerships, this is the simplest structure for two or more people who own a business together.

Partnerships have three common types of classifications: general partnership, limited partnership, and limited liability partnership. A general partnership has partners who share liabilities and responsibilities equally. They take part in the day-to-day operations of the business and are equally liable for any debts generated by the business. In a limited partnership (LP), there is typically a general partner and a limited partner. The general partner would assume ownership of business operations and have unlimited liability. The limited partner acts as a silent partner by investing capital into the business while not being involved in day-to-day operations with limited liability. Limited liability partnerships (LLP) have all partners assuming limited personal liability. This means that a partner cannot be liable for the wrongdoings of another partner. All partners are typically involved in the management of the company and tend to have more flexibility in day-to-day operations. A partnership will file a Form 1065 and each partner will receive a K-1 to report on their tax returns.

A limited liability company (LLC) is a hybrid business structure that limits the personal liabilities of owners. With an LLC, you can select to elect your status as a sole proprietor, partnership, or corporation depending upon the number of owners. This lends more protection and flexibility than some of its business structure counterparts. LLCs protect owners from personal liability in most instances. Personal assets such as a vehicle, house, and savings account will not be at risk if the LLC faces bankruptcy or lawsuits. It is important to note that LLCs are formed under state law and regulations that may vary from state to state. When thinking about incorporating, there are two options to choose from.

You may elect to be structured as a C Corporation, or an S Corporation. S Corporations are pass-through entities just like a partnership, however, the IRS institutes strict standards for companies looking to qualify for S Corporation status. For example, an S Corporation can only have 100 shareholders or fewer, and they must be U.S. citizens/residents. S Corporations file Form 1120S and issue K-1s to shareholders to report their share of profits on their return. C Corporations are considered the default for corporations. C Corporations offer the strongest protection to its owners from personal liability.

C Corporations will pay tax on profits at the business level at a flat rate (21%). C Corporations often are criticized for "double taxation" due to paying taxes at the corporate level on profits and again at the personal level when dividends/salary are paid to shareholders. C Corporations file form 1120 and there are no pass-through forms to shareholders. Choosing the correct business structure that fits your long-term goals, ownership plans to hire employees, and legal risk is one of the most important steps in becoming a business owner. With there being an abundance of important tax and legal implications, it is well worth the cost to consult with an attorney and/or a tax expert in making your decision. Contact the professionals at The Center for Financial, Legal, and Tax Planning, Inc. Our office can provide the best of both worlds when it comes to legal and tax advice for business structures. We would love to assist you in achieving your dreams of being a successful business owner! Please contact us at (618) 997-3436.

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