



Give Your Company Some Structure

Decision has tax and legal implications.

As most small business owners know, starting a company is far more complex than just hanging out a shingle. Business start-ups must consider a plethora of issues, and how to structure the business should be at the top of the list. Business structure affects every aspect of a company, and is one of the first and most important decisions an entrepreneur must make.

Before deciding on a legal organization, business owners should consider the following questions:

- * What are my capital needs? How much cash will it take to run the business?
- * How will I get those funds?
- * How fast do I expect the company to grow? Where will it be in one, three, five or 10 years?
- * What is my income tax situation?
- * What type of property will the company own?
- * What income do I want to shelter through retirement plans?
- * How much risk and liability does my new business pose?
- * Who are the owners, and how active will they be in the business?
- * How will I deal with conflicts among owners?
- * Will I use cash or accrual accounting?

There are several business structures to choose from, and all are governed by laws of the state in which the company operates. A company may operate as a sole proprietorship, a partnership, a corporation or an LLC. Each structure has distinct benefits and disadvantages. Choosing the form correctly at the beginning is important, because it can be quite expensive from a tax perspective to change down the road.

Sole Proprietorship

A sole proprietorship, the simplest and most common business structure, is easy to form and operate. The sole proprietor has complete control of the company, and filing taxes simply requires a self-employment

income tax form. Sole proprietors also typically must make quarterly estimated tax payments, because they do not have taxes withheld from their business income. As with all business forms, it is imperative that sole proprietors keep business and personal expenses separate.

Since a sole proprietorship offers no corporate protection, the owner assumes full legal liability for the business, but business liability insurance can offer some protection in this area for sole proprietors.

Partnership

General partnerships are likely the default entity structure if two or more people in a business venture do not actively form a different type of entity. In a general partnership, each partner can bind the entire group; from a legal standpoint, if one partner acts irresponsibly, every partner is held equally accountable.

Without a more structured agreement, general partners can act independently without one another's approval. A partnership offers no liability protection, so partners are personally responsible for the business' financial obligations and debts.

For tax purposes, a partnership is taxed at the partner, or owner, level so there's no double income taxation.

Corporations

Though more complex than a general partnership, a corporation provides liability protection from claims made against the company. A business owner who organizes a company as a corporation generally is not personally liable for the corporation's debts, unless they are personally guaranteed.

Dividend earnings distributed to shareholders are taxed at their individual personal tax rates. With an S-corporation, owners avoid double taxation. Providing "pass-through" taxation, profits from an S-corporation are taxed only at the owner, or shareholder, level.

In contrast, profits from a C-corporation are taxed at both the owner and corporate

levels. C-corporations may be able to reduce their income tax by distributing much of the profits to the shareholder-owners as salaries, but such salaries would be subject to payroll taxes. C-corporations can also issue common and preferred shares or voting and non-voting shares of stock. Most large entities and many public companies operate as C-corporations.

Limited Liability Company

A limited liability company, or LLC, is a partnership-corporation hybrid. LLCs are flexible and can provide pass-through taxation at only the owner level, and can readily separate ownership

from control. Thus, an investor may own 70 percent of the company for purposes of receiving 70 percent of the profits but, in reality, the "sweat equity" entrepreneur may have actual manage-

rial control of the business. An LLC uses an operating agreement to define the relationship between multiple owners and provides the liability protection of a corporation.

Entrepreneurs should consult with both an attorney and an accountant before selecting one type of business structure over another, as the employment, franchise and income taxes applicable to a particular entity, issues of control, dissolution and division of profits all must be considered. The right structure and documentation can guide a company through the inevitable challenges and triumphs all business owners face at one time or another.

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