



Setting Up the Right Business Entity

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Objectives

1. Discuss Incorporations & Online Business Filings for Accounting Professionals
2. Understand Business Entity Types
3. Discuss Tax Implications for Business Entities
4. Online Filing Options to Simplify the Process

The Incorporation Opportunity

- 6 million New to the world businesses form each year in US.
- 2.2 million New Businesses Incorporate every year
 - Percentage done online ~ 5.5%
- Most incorporate their business at the time of start-up*
 - 62% incorporated a start-up business
 - 26% incorporated an established business
 - 12% said their business was in-between at time of incorporation
- Accountants are typically the key source for incorporation information for their clients.

Business Formations – Types and Filing Requirements

Business formations come in many different shapes and sizes -
Depending on the client's needs, short & long-term goals.



*Business Entity
Types -
No Filing Required**

Sole Proprietor

General Partnership

Limited Partnership

**but no liability or asset protection...*



*State/Federal Filing
Required*

C-Corporation

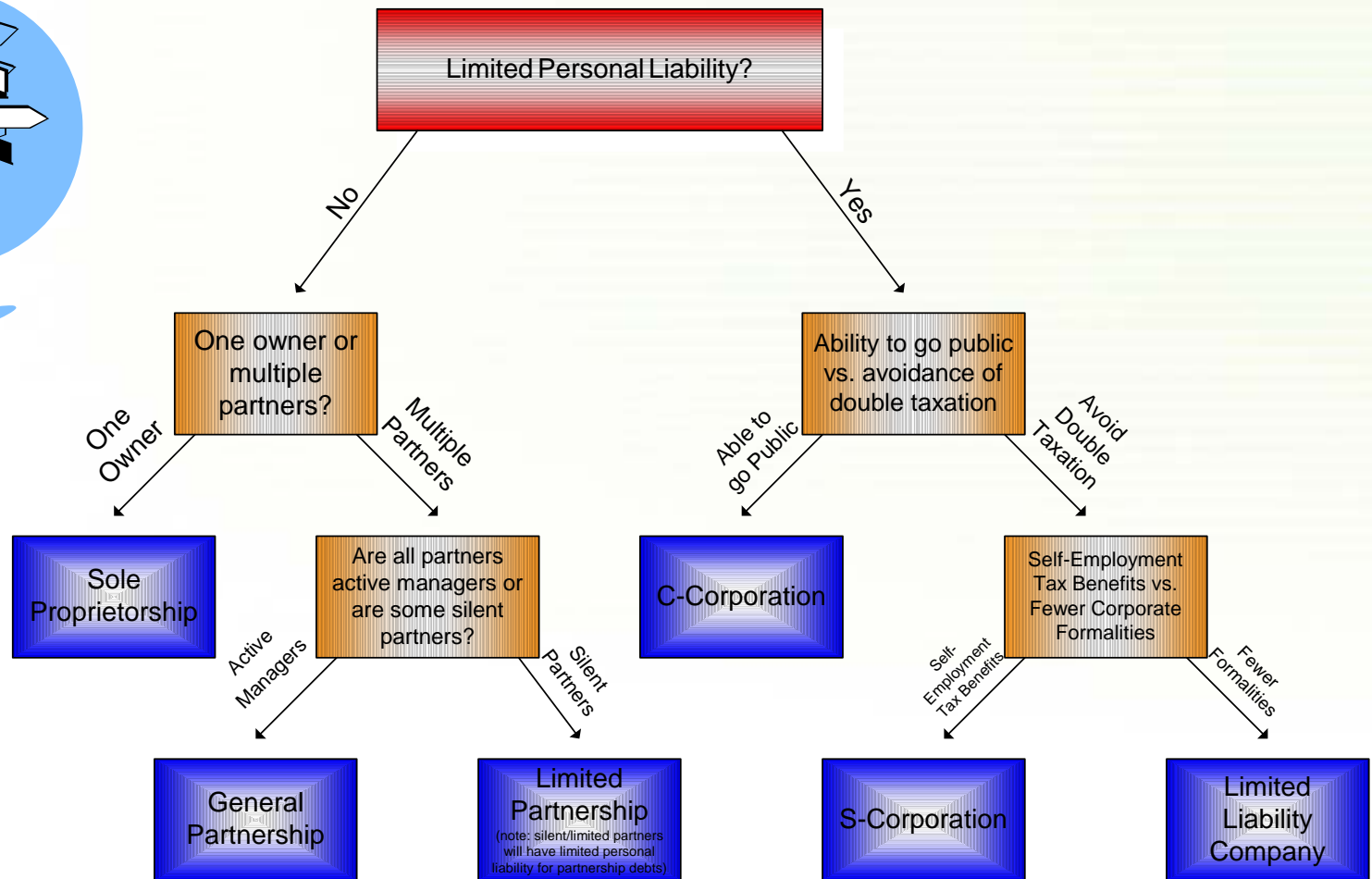
S-Corporation

Limited Liability Company

Professional Corporation

Non-Profit Corporation

Entity Selection Decision Tree



Sole Proprietorship



Characteristics of Business Type

- Business is operated by a single person.
- The owner is not considered an employee (rather, self-employed)
- The simplest form of business.
- Comparatively easier & less expensive to maintain.
- Separate business and personal books are kept.

Legal Factors/Requirements

- An individual can start up a sole proprietorship.
- No legal formalities.
- Business licenses or permits may be required.
- May be subject to unlimited personal liability. All assets & liabilities of the company are the assets & liabilities of the individual.
- Business income is reported on the individuals' Form 1040, Schedule C.

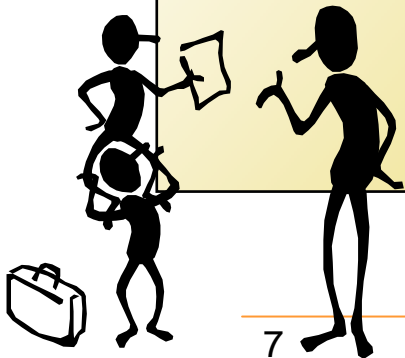
General Partnership

Characteristics of Business Type

- Business is operated by two or more people.
- Partnership agreement should be prepared.
- Partners are not considered employees of the company, but self-employed individuals.

Legal Factors/Requirements

- Personal and partnership assets may be at risk.
- Not required to pay separate business income taxes.
- Must file an information return indicating amount of money earned or lost during the year by each partner.
- Each partner is responsible for paying their share of personal income tax.
- Depending on the business type and location, may be required to obtain business licenses or permits.
- May be required to file a partnership certificate with a public office.



Limited Partnership



Characteristics of Business Type

- A partnership that is made up of one or more general partners and one or more limited partners.
- The big difference between a general partner and a limited partner is that the limited partner is not personally liable for debts of the partnership.
- Limited partners can only lose the amount they paid as a capital contribution or received from the partnership.
- A limited partner may not participate in management of the business.
- If a limited partner does participate, he or she may incur personal liability with the same repercussions as a general partner.

Legal Factors/Requirements

- Serves as a means to raise money from limited partners
 - without having to take in new partners as active members in the business or
 - engage in the complexities of starting a corporation and issuing stock.
- Depending on the business type and location, may be required to obtain business licenses or permits.
- May be required to file a partnership certificate with a public office.

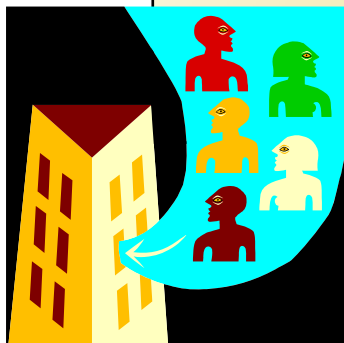
C-Corporation

Characteristics of Business Type

- Considered a separate entity from those who own or operate it.
- Limited personal liability and protection from being personally liable for debts (e.g., bills for supplies/equipments and injuries to persons involved in business activities that are not adequately covered by standard insurance)
- One person may own all the stock
- Has its own name and identity.
- All assets and liabilities belong to the corporation.

Legal Factors/Requirements

- Created under state law (by filing documents with the Secretary of State).
- Tax must be paid on the income made by the corporation.
- If income is distributed to shareholders as dividends, the shareholders must pay tax on amount received as dividends.



S-Corporation

Characteristics of Business Type

- Limited liability and protection from being personally liable for debts.
- Business owners pay income taxes in the same manner as a sole proprietor or a partner.
- Business losses may be offset against other income, which may reduce or eliminate the business owner's tax burden.
- Generally not subject to taxation at the federal level.
 - The advantage of an S corporation is the ability to escape the corporate "double taxation."
- Shareholders are required to pay their share of income tax on the corporation's income, whether or not they received money.

Legal Factors/Requirements

- S-Corporations begin their existence as a C-Corporation at the state level.
- Within the first 75 days from the date of incorporation, IRS Form 2553 to elect S-Corporation treatment must be filed
 - Income of the corporation is only taxed at the individual shareholder level, and not at the corporate level.
- No more than 100 shareholders.
- Ownership is limited to U.S. citizens and resident aliens in the U.S.
 - Cannot be owned by other business entities (i.e. a C-Corporation, S-Corporation, or LLC).
- Not subject to self-employment tax on shareholder's income from the corporation
 - Subject to self-employment taxes on salary paid.



Limited Liability Company



Characteristics of Business Type

- Limited Liability Companies combine the limited liability advantages of corporations with the control and tax advantages of a partnership.
- A Limited Liability Company is more complicated than a normal partnership in its formation.
- Limited Liability owners are generally not liable for the debts and obligations of the LLC.
- Can elect how an LLC will be taxed.

Legal Factors/Requirements

- The entity is taxed like a partnership- income and losses of the LLC are accounted for on the owner's individual tax returns.
- Can be owned by non-U.S. citizens / resident aliens and other business entities
 - one LLC can own some or all of another LLC or C-Corporation).
- Can have unlimited number of members
 - owners of an LLC are known as members
- Less formal than a corporation
 - no minutes, corporate resolutions, or other corporate formalities are required

Professional Corporations & PLLCs

Characteristics of Business Type

- Certain occupations, e.g., physicians, attorneys & accountants, may incorporate their practice through a professional corporation only.
- Some professionals in some states may incorporate as a professional corporation or as a regular corporation.
- All shareholders must be licensed.

Legal Factors/Requirements

- Created under state law (by filing documents with the Secretary of State).
- Limited personal liability and protection from being personally liable for debts of other members.
- Still liable for own malpractice.



Similarities between **S-Corporations & LLCs**

Similarities

Formation – Both entities are separate legal entities created under state law by filing Articles of Incorporation/Organization with Secretary of State.

Liability – Both entities provide strong liability protection for owners, meaning the owners are generally not liable for the debt/liabilities of the business.

Taxation – Both entities are pass-through entities. The income or loss from the business is passed through to the individual owners who in turn pay any income tax due.

Differences between S-Corporations & LLCs

Differences

- **Ownership** – Owners of LLCs are called members and owners of S-Corporations are called shareholders. There are significant differences in the number and type of owners each entity may possess.
 - S-Corps may not have more than 100 shareholders; LLCs may have an unlimited number of members.
 - S-Corps are not allowed to have non-U.S. citizens as owners; there is no such restriction for LLCs.
 - S-Corps cannot be owned by other corporations, partnerships, LLCs or certain types of trusts. LLCs do not have these restrictions.
- **Formalities** – S-Corps must adhere to certain formalities in order to retain their legal corporate status. These formalities include holding annual shareholders' and directors' meetings and keeping corporate minutes of those meetings. LLCs do not have to follow such formalities.
- **Transfer of Ownership** - Corporate shareholders may freely transfer their ownership shares without restriction. LLCs members generally have to obtain approval from the other members before doing so.
- **Management** – S-Corps have centralized management, which means that a person (or group of people) has the authority to make the management decisions necessary to run the business. An LLC may be managed by its members, in which case it is similar to a partnership. Or it may be managed by appointed managers, in which case it will have centralized management similar to a corporation.
- **Allocation of Income** – Income from an S-Corp must be allocated to its shareholders based on stock ownership. LLCs may specially allocate income and losses to its members irrespective of ownership percentage.
- **Self-Employment Tax** - S-Corps are not subject to self-employment tax on their share of income from the corporation (although they are subject to self-employment taxes on reasonable salary paid). The law is not clear on this issue for LLC members.

Overview of Incorporations

Sole Proprietor

- File on Schedule C of Form 1040
- 2 Income tax returns; 1 Federal 1040 and on State
- No corporate vial, owner is liable

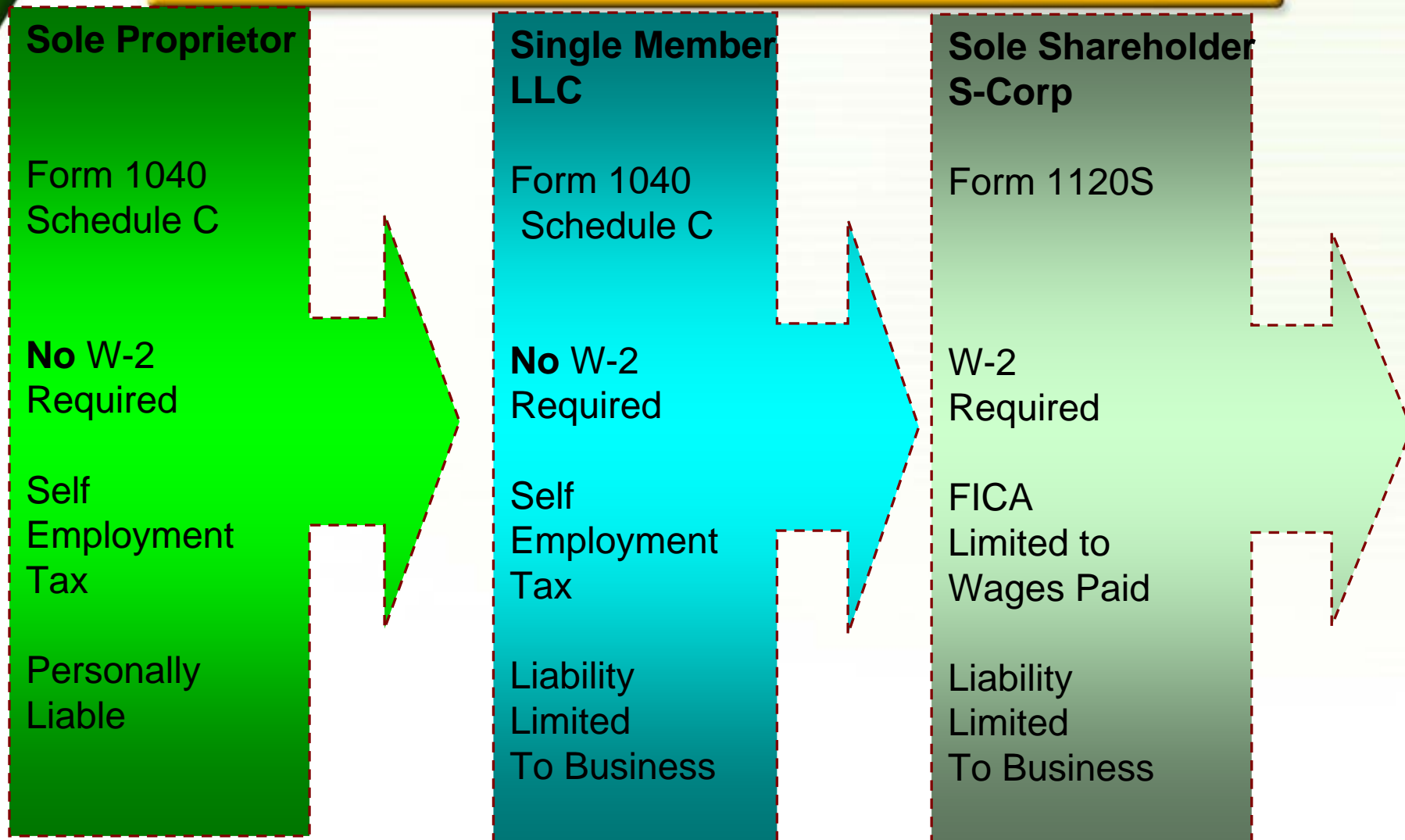
Limited Liability Company

- If 2 or more Members files on Form 1065
- A total of **4 tax returns** required
 - Form 1065
 - State Franchise Tax
 - Form 1040
 - State Individual

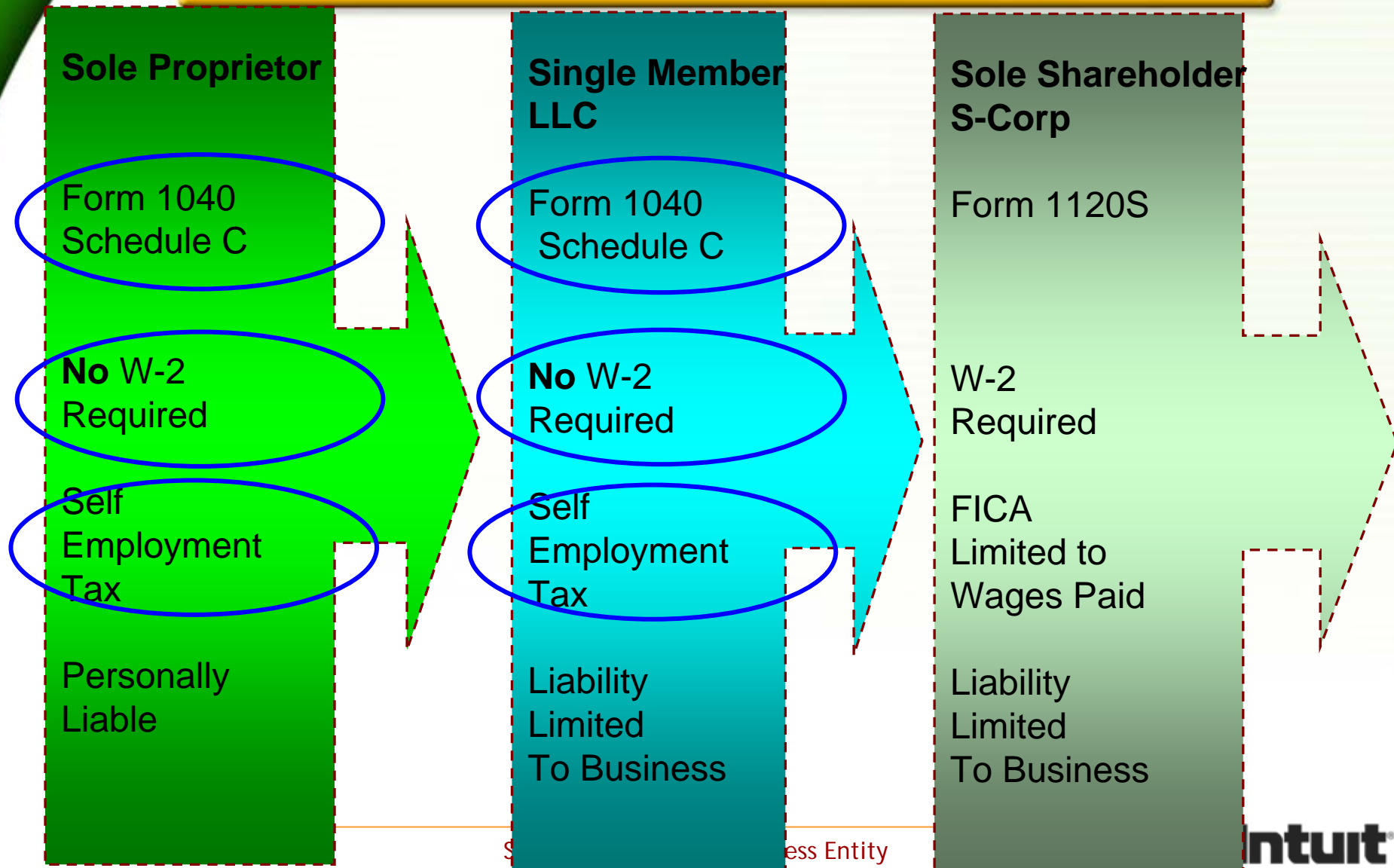
S-Corporation

- Regardless of the number of shareholders S-Corps must file :
 - Form 1120-S
 - State Franchise Tax
 - Form 1040
 - State Individual

Single Owner Comparison



Single Owner Comparison



Sole Prop vs. LLC

Form 1040 Schedule C

- Both a Sole Proprietor and a Single Member LLC file on Schedule C of Form 1040 for federal income tax purposes
- Note that an LLC may be required to file a franchise tax return in some states

No W-2s

- Both Sole Proprietors and Single Member LLC owners are NOT required to report their income on Form W-2
- Note that if either have employees they both would be required to report employee income on Form W-2

Self Employment Tax

- Both Sole Proprietors and Single Member LLC owners are subject to self employment tax

Medical and Retirement Benefits Paid by Entity

Entity Treatment	Partnership/LLC	S Corporation	C Corporation
Medical Insurance	Deducted as Guaranteed Payment	Deductible as W-2 wage/compensation not subject to FICA/Medicare	Deductible as operating expense in same manner as payments for non-shareholder Employees
Retirement Contributions	Distribution to partner/member	Deductible as operating expense in the same manner as for non-shareholder employees	Deductible as operating expense in the same manner as for non-shareholder employees

Partner/Member/Shareholder Treatment

Medical Insurance	Deductible as an adjustment to income on page 1 of Form 1040	Income included in W-2 Box 1, explanation in Box 14; deduct on Form 1040 as SE medical insurance	Not income to employee/shareholder; no entry on Form 1040
Retirement Contributions	Deductible as an adjustment to income on page 1 of Form 1040	No entry for 1040	No entry for 1040

Clients Interested in Incorporation/LLC Formation Services

- Start-ups with 1-2 employees
- Work in the following industries:
Professionals, Business Services, Finance/Insurance/Real Estate, Construction
- Feel they should incorporate to protect their family and personal assets
- May need to incorporate to raise capital, get funding, start a practice
- Interested in saving time and money **on the filing—but in order to “do it themselves” online, they need to feel confident in their decision and the reliability of the service.**



Incorporation & Accountants

Accountants are viewed as the **#1 expert** on selecting an entity type.

- **95% of accountants discuss entity type** with their clients
- **Most MyCorporation customers use a Pro/accountant for taxes**
- **Almost 4 in 10 consult with an accountant about entity type, first, before using MyCorporation**



Accountants Say:

"Choosing the right business entity is one of the most important decisions a business person will make. We like to meet with our clients to compare the pros and cons of each entity choice so the client will have the information to make an informed decision."

Helping Clients with the Incorporation Process

MyCorporation provides a self-service solution for Accounting Professionals to help their clients form a new business entity - allowing you to choose their desired level of control of the formation process with each individual client.



Provider

Incorporate/form LLC for client

Complete online application

Receive documents on behalf of client

Work with client on corporate maintenance issues

Model: Outsourced



Collaborator

Help client decide type of entity to form from tax perspective

Complete online application with client

Work with client on corporate maintenance

Accountant-Assisted



Recommender

Advise clients on tax benefits of incorporation/LLC formation

Recommend online formation service to client

Do-It-Yourself

Incorporation Service

Option for APs: Affiliate Program/Discount

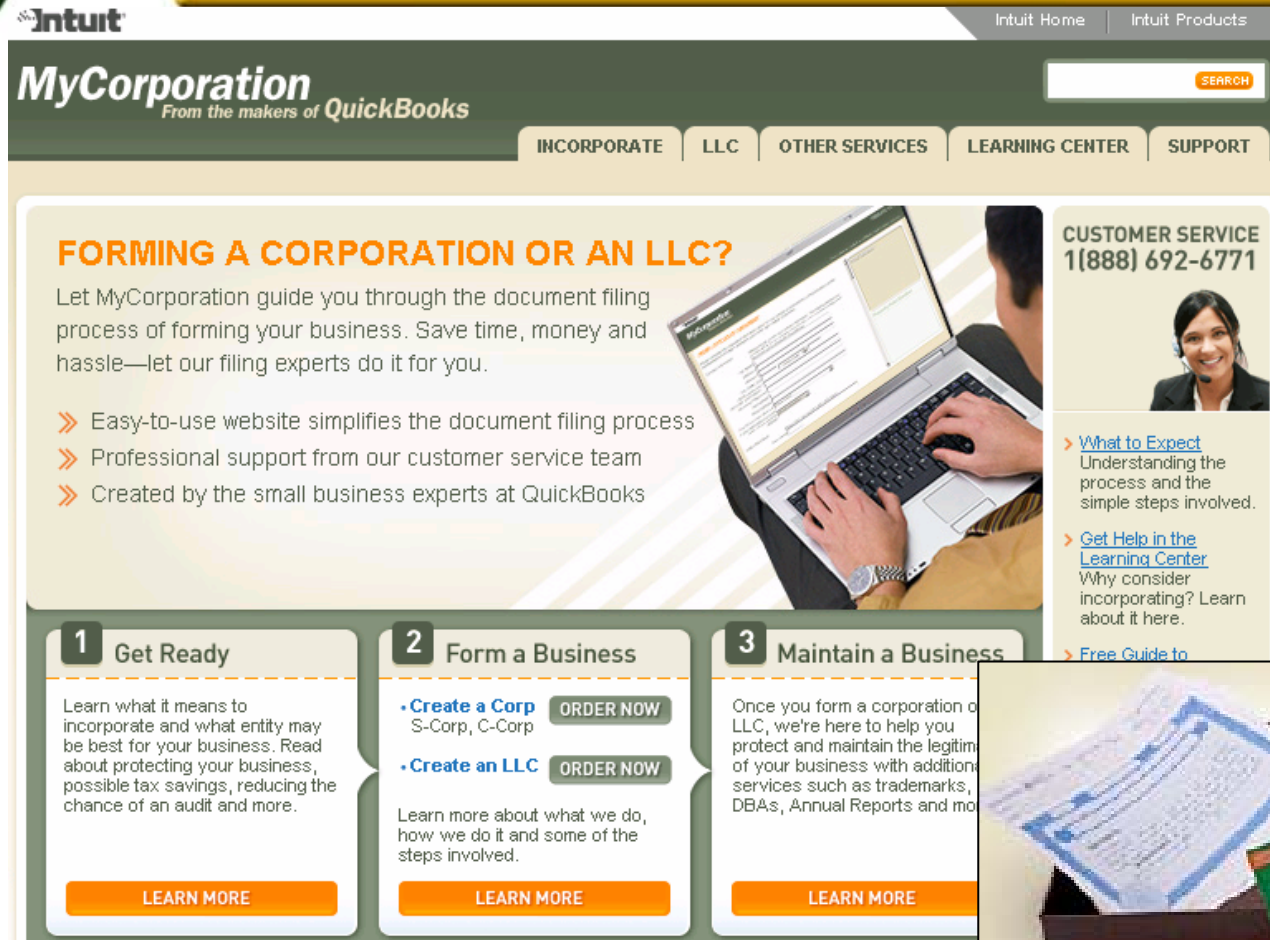
Provide discount for client's use

MyCorporation

The easy, reliable way to form and manage your corporation or LLC.

- **Streamlines the filing process for small business owners**
 - Easy-to-use website guides you step by step
 - Expert customer service help on the filing process
 - Corporate Kit keeps your official documents organized
- **“Done right” results**
 - MyCorporation keeps track of the latest requirements for every state
 - After you file, MyCorporation can help you stay in good standing
- **Less expensive than a lawyer**
 - Our prices are set (starting at just \$149 plus state filing fee) vs. a lawyer charging \$200 an hour, on average
- **From the small business experts at QuickBooks**

File Online



The screenshot shows the Intuit MyCorporation website. At the top, the Intuit logo is on the left, and navigation links for "Intuit Home" and "Intuit Products" are on the right. Below the logo, the text "MyCorporation From the makers of QuickBooks" is displayed. A search bar with a "SEARCH" button is on the right. A horizontal menu contains links for "INCORPORATE", "LLC", "OTHER SERVICES", "LEARNING CENTER", and "SUPPORT". The main content area features a large section titled "FORMING A CORPORATION OR AN LLC?" with a sub-header "Let MyCorporation guide you through the document filing process of forming your business. Save time, money and hassle—let our filing experts do it for you." Below this, three bullet points with orange arrow icons describe the benefits: "Easy-to-use website simplifies the document filing process", "Professional support from our customer service team", and "Created by the small business experts at QuickBooks". To the right of this text is an image of a person using a laptop. Further right, a "CUSTOMER SERVICE 1(888) 692-6771" section includes a photo of a smiling woman and two links: "What to Expect" (Understanding the process and the simple steps involved) and "Get Help in the Learning Center" (Why consider incorporating? Learn about it here.). Below the main content, there are three numbered steps: "1 Get Ready" (Learn what it means to incorporate...), "2 Form a Business" (Create a Corp S-Corp, C-Corp and Create an LLC, each with an "ORDER NOW" button), and "3 Maintain a Business" (Once you form a corporation or LLC, we're here to help you protect and maintain the legitimacy of your business...). Each step has a "LEARN MORE" button. An inset image in the bottom right corner shows a brown leather folder containing documents, a CD-ROM, and a small green QuickBooks booklet.