

Which Business Entity is Best for You?

Sole Proprietor?

Partnership?

Corporation?

LLC?

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Disclaimer!

- This information is intended to provide a general overview of business entity types, and how to form and maintain these entities. It is not intended to constitute legal or tax advice. You need to consult your Legal and Tax advisors.

Overview

- Entity Types Available
 - Sole Proprietorship, Partnerships, Corporations, LLC's
- Choosing an Entity Type
- What is Next – Steps to Register & Form
- Open Forum

Entity Types Available

Sole Proprietorship

- Most Common form of Entity Type
 - 23 million filed as Schedule C's in 2010
- Is simplest and cheapest form
- Is formed with one owner
- File a Master License Application – Dept of Revenue (DOR)
- May be right for many
- Unlimited liability
- Should avoid for high risk business

Entity Types Available

Sole Proprietorship con't

- Income flows to individual via Schedule C
- Drawback – owner cannot be on payroll
 - Need to be disciplined in budgeting
- Makes estimated tax payments
- Should spend some time with Accounting and Tax Professional to discuss if this is right for you!

Entity Types Available

Partnerships

- A relationship between two or more persons who join together to carry on a trade or business.
 - 3,626,000 US (WA 77,899)
- Files Form 1065, *US Partnership Return of Income - information only*
- Each partner receives a Schedule K-1 (Form 1065): *Partner's Share of Income Credit, Deductions, etc (See page 23, Instructions for 1065)*
- Partner completes Schedule E of Form 1040
- Subject to Self Employment Tax
- Publication 541 Partnerships

Entity Types Available

Partnerships con't

- MUST have a Partnership agreement
 - Preferably by an Attorney – Handshake days are gone
 - State law does impose some limits on partnership agreements
 - Accountants CANNOT give legal advice!
- Spend the money now for a proper set-up to save long and costly battles in the future
- No protection from individual liability for General Partners
- Liable for other partner's acts

Entity Types Available

Corporations – Two Types

Regular Corporation (C-Corp) - Files Form 1120

US Corporation Income Tax Return

- *2,263,000 US (39,941 WA)*
- *Possible double taxation*
 - *Corporate level and Shareholder level*
- *Individual Liability Protection*
- *Articles of Incorporation via Secretary of State (SOS)*
 - *Ease of transferability (stock sales)*
 - *Unlimited Shareholders*
- Shareholders receive dividends- 1099DIV
- Employees receive Form W-2
- NOT subject to SE Tax (subject to Income Tax)
- Publication 542

Entity Types Available

Corporations con't

S Corporation (S-Corp) - Files Form 1120S

- 4,580,000 US (96,496 WA)
- No Foreign ownership, 100 S/H
- Reasonable compensation
- Taxed similar to a partnership (Form 2553 to make election)
 - Shareholder receives Schedule K-1 (Form 1120S): *Shareholder's Share of Income, Credits, Deductions, etc*
 - Shareholder completes Schedule E of Form 1040
 - NOT Subject to SE Tax (Wages subject to FICA)
 - The Profit as long as reasonable compensation is not an issue

Entity Types Available

LLC's

- Formed by filing Certificate of Formation with SOS
- Not a Federal tax entity (Pub 3402)
- Multiple Member LLC Generally Considered a Partnership
- Single Member LLC Generally Considered a "Disregarded Entity" & Files as Sole Proprietor
- Limited Liability Protection
- More flexible form of Business Entity
- Can elect to be treated as a C-Corporation - Form 8832 or S-Corporation – Form 2553

Entity Types Available

Entity Table

Entity Type	US	WA
Sole Proprietor	23,000,000	??
Partnership	3,626,000	77,899
C-Corporation	2,263,000	39,941
S-Corporation	4,580,000	96,496

Source: IRS Tax Book Statistics

Choosing an Entity Type

Criteria to Consider:

- Risk Potential & Liability
- Accounting & Tax Implications
- Costs & Degree of Difficulty to Form
- Costs & Degree of Difficulty to Maintain

Choosing an Entity Type

What is the Risk Potential?

- Evaluate the business for the potential risks
- Talk to your Accountant, Attorney, Insurance Broker, Banker, Real Estate Broker
- Look at the employment litigation possibilities
- Look at the type of industry you are in
 - The riskier business may prevent Insurance Coverage – hence an LLC or a Corporation may be the right fit
- Play it safe and carry Insurance and Incorporate or form LLC

Choosing an Entity Type

Seek Accounting and Tax Advice

- You might NOT be an Accountant or Tax Professional
 - Each Entity Type will be taxed differently
 - Should you be a Sole Proprietor, C-Corp, S-Corp
 - Do you have Employees?
 - Do you want to be on payroll??
 - Sole Proprietor cannot be
 - S-Corp shareholder/employees must be on payroll
 - Do you have foreign ownership?
 - How many shareholders will there be?

Choosing an Entity Type

Legal Advice

- Work with a Legal Professional to create the LLC, Partnership or Corporation
- Accountants CANNOT legally create a Corporation or LLC
- Have Attorney review (create) contracts to protect against frivolous lawsuits
- Have Attorney create Bylaws, Operating Agreements
- Spending the time and some money now to save the headaches later!

What is Next??

Register & Form

- DOR – Business License Application
- Secretary of State
- Other State Agencies (eg, Labor & Industries)
- Local Jurisdictions (eg, City business license)
- Range of Options
 - DIY → Filing Services → Attorneys

Ongoing Business Relationships

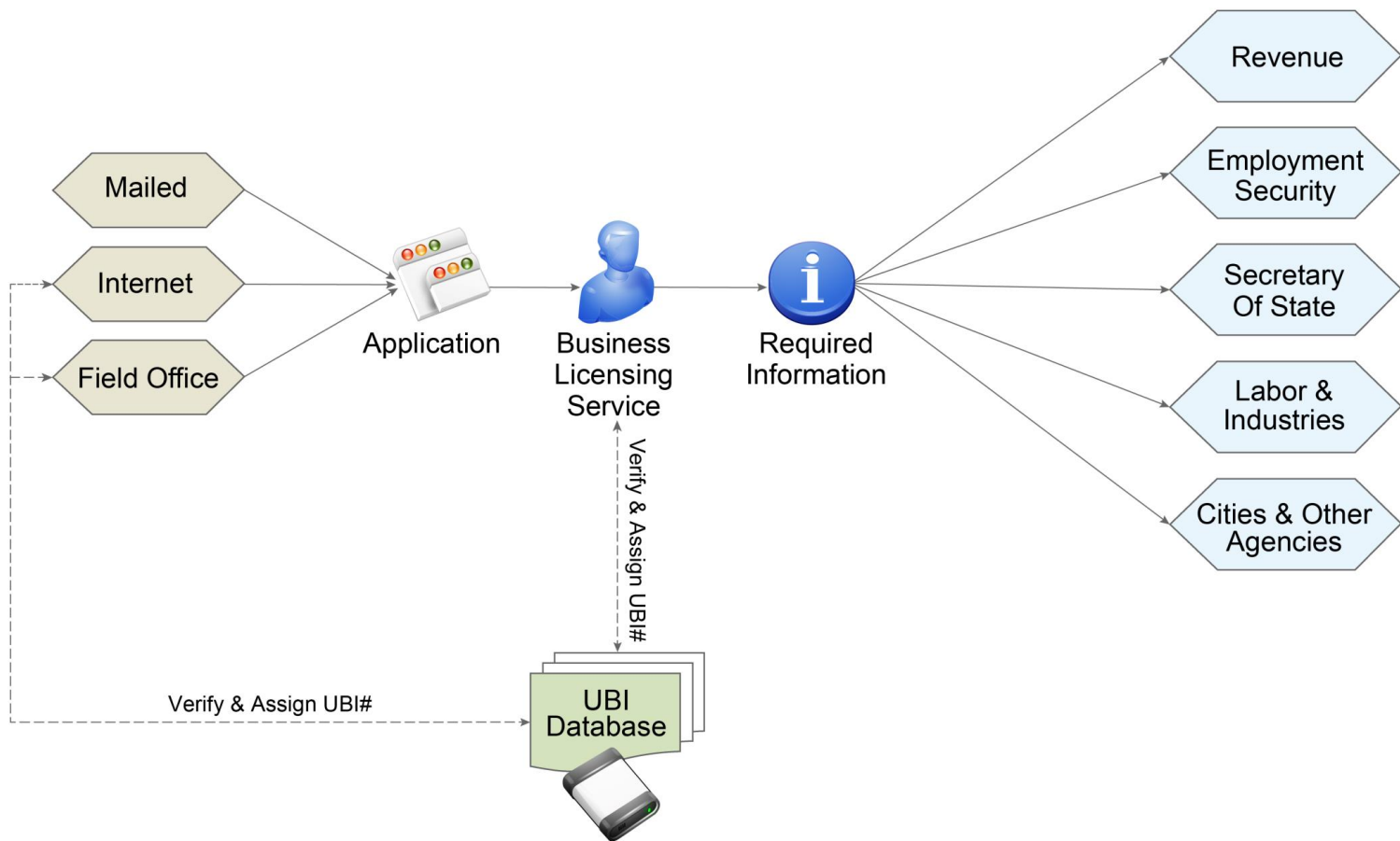
Registering with DOR Business License Application

- Register/Reopen Business
- Change Ownership
- Register Trade Name
- Change Trade Name
- Change/Open Location
- Hire Employees

•*Note if you are an LLC or Inc,
must register with the Secretary of
State (SOS) first

The image shows a stack of 'Business License Application' forms from the Oregon Department of Revenue. The top form is clearly visible and contains the following information:

- Purpose of Application:** A list of checkboxes for various reasons such as 'New Business', 'Change Ownership', 'Change Location', etc.
- License Fee:** A table with columns for 'Fee Type', 'Amount', and 'Total'. It lists 'Business License Fee' and 'Processing Fee'.
- Total Amount Due:** A box containing the value '\$18.00'.



What is Next??

Business Relationships

- Building Business Relationships may be hard BUT breaking up and shutting down is even harder
- Choose your Partners, S/H's, Employees carefully
- Take your time in the beginning to do your due diligence to mitigate losses
- You will need to trust the Partners, EE's, Vendors etc you have selected for their speciality
 - Let them do their job!

What is Next Con't

Ongoing Relationships

- Have ongoing dialogues with your:
 - Accountant
 - May be most important ongoing business relationship. Do NOT scrimp here!
 - They will probably be working on your Payroll, Sales, B&O, Income and other taxes and should be kept abreast of everything
 - Legal Counsel
 - Probably next most important ongoing business relationship
 - Will require input for Entity requirements like Corporate Framework, admitting/removing S/H, leases, other contracts, buy/sell agreements and so on

What is Next Con't

Ongoing Relationships

- Have ongoing dialogues with your:
 - Insurance Broker
 - Should NOT be an afterthought
 - Business needs change and so should your coverage
 - Meet with your broker a couple of times a year to go over coverage
 - Banker
 - Typically bankers get left out of the picture but you need to maintain a good working relationship with them
 - Needs could change and if you have a good relationship it can do wonders for your business

Summary

Comparison Chart

Entity Type	Liability	Taxation	Formation	Corporate Maintenance
Regular C-Corporation (Inc)	Owners have limited personal liability for business debts.	Separate taxable entity. Pays Income Tax	May have an unlimited number of shareholders.	Shares of stock may be sold to raise capital
		Fringe benefits can be deducted as business expense.	More expensive to create than partnership or sole proprietorship. Register with SOS.	Formality requirements (e.g. annual reports, minutes, meetings) are required to maintain corporate status.
S-Corporation (Inc)	Owners have limited personal liability for business debts.	Owners report their share of corporate profit or loss on their personal tax returns.	More expensive to create than partnership or sole proprietorship. Register with SOS.	More formality requirements than for a limited liability company which offers similar advantages.
		Owners can use corporate loss to offset income from other sources.		
		Fringe benefits limited for owners who own more than 2% of shares.		

Summary

Comparison Chart

Entity Type	Liability	Taxation	Formation	Corporate Maintenance
Limited Liability Company	Combines a corporation's liability protection and pass-through tax structure of a partnership.	IRS rules allow LLCs to choose between being taxed as sole proprietor, partnership or corporation.	More expensive to create than partnership or sole proprietorship. Register with SOS.	Sale of member interests may take place per company policy.
Sole Proprietorship	Owner personally liable for business debts.	Owner reports profit or loss on his or her personal tax return.	Simple and inexpensive to create and operate. No filing necessary with SOS.	
General Partnership	Owner (partners) personally liable for business debts.	Owner (partners) reports profit or loss on his or her personal tax returns.	Simple and inexpensive to create and operate. No filing necessary with SOS.	
Limited Partnership	Limited partners have limited personal liability for business debts as long as they don't participate in management.		Suitable mainly for companies that invest in real estate.	General partners can raise cash without involving outside investors in management of business.
			More expensive to create than general partnership.	General partners personally liable for business debts.

Question and Answer!!

Thank you!

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