

*Got business questions?*

# **Ask SCORE**

*By: Gray Poehler, Business Counselor*

**QUESTION:** *Should we Incorporate our new business or file as a Limited Liability Company (LLC). Please explain the advantages of each.*

*Chick H., Naples*

**ANSWER:** *Chick, Many small business owners are so preoccupied with the daily tasks of managing their companies that they don't stop to consider whether they are operating under the most advantageous organizational structure. Decisions about choosing a business structure have far-reaching tax and liability consequences.*

*The most common structure for a small business is a Sole Proprietorship, in which the business is owned by one person. Another popular form is a Partnership, in which two or more individuals conduct business as co-owners. Advantages include a simple, inexpensive way to create and operate and the owner(s) report profit or loss on their personal tax return. The main drawback is that the owner(s) are personally liable for the business's debts and any judgments that may arise. Also, there is no beneficial employment tax treatment.*

*The decision to Incorporate or form a Limited Liability Company (LLC) provides a number of clear advantages. These are legal business entities that are separate from their owners. This means that corporate owner/shareholders and LLC owners are protected from liability for the company's debts. If the business gets into serious financial trouble, the law prevents creditors from coming after personal assets, so long as the debt was not personally guaranteed. There is also a measure of personal protection from liability judgments, although there is some debate on this issue if you are an officer or director of the company. Other advantages include the ability to raise capital from the sale of stock or additional interests in the entity, and there is some favorable tax treatment.*

*There are two types of Corporations. The "C" corporation or general corporation's main advantage is that it has no limitation on the number of shareholders or classes of stock. It is more appropriate for companies planning to have more than 30 stockholders. The disadvantages include the costs to create and operate. Additionally, profits may be subject to double taxation ( i.e. corporate income is taxed, and then dividends paid to shareholders are taxed as part of the individual's personal income).*

*The "Subchapter S" corporation is a general corporation that has selected a special tax status with the IRS after the corporation has been formed. All profits are distributed to shareholders on a pro rata basis, who then pay personal income taxes on them. The main advantage here is the avoidance of the double taxation peculiar to the "C" corp.*

*Also, in the early stages of a business, when losses can be incurred, the owners can write off operating losses on their personal tax returns. A disadvantage of the “S” corporation is that it is limited to 75 owners, all of whom must be U.S. citizens or permanent residents. Also, there can be only one class of stock and some restrictions on fringe benefits.*

*The Limited Liability Company “LLC” has grown quickly as a favored business structure for small businesses. It offers the flexibility of a partnership and the liability protection of a corporation, with far less paperwork. It can have an unlimited number of owners and its profits and losses may pass directly to the owners. The owners can establish their own membership agreement, with voting rights, and income divided as desired. Thus, for many start-up and growing businesses, the LLC may offer the best of all operating structures. There are few, if any, disadvantages to the LLC.*

*This article is not intended to favor one entity over another. You should consult with an attorney and tax accountant who can help you determine which organizational structure is best suited to your particular needs. SCORE business counselors can also assist you with advice and literature on the subject. There is no charge for counseling. The Naples SCORE business office is located at 900 Goodlette-Frank Road in the Fifth Third branch bank. Business hours are from 9:00 AM to Noon, Monday through Friday. Appointments can be arranged by calling (239) 430-0081, or visit our Web site [www.scorenaples.org](http://www.scorenaples.org). Click on “request counseling NOW as a first time client”; then follow the instructions to fill out the “request for counseling form”.*

*If you would like the answer to your question considered for publication in this bi-weekly column, please fill out the form located at [www.scorenaples.org/askscore](http://www.scorenaples.org/askscore). Please include your name, address and a contact phone number.*