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**Basic Considerations When Forming a New Business**

Individuals starting a new business often approach us with basic questions surrounding their new venture.  Typically, these individuals have heard that they need to “incorporate” their business to protect themselves from personal liability, and they are generally aware that there are tax implications that are driven by their decisions when forming the new business.  Thus, the initial choices are (1) choice of entity, and (2) tax matters.

**Choice of Entity When Forming a New Business**

There are a variety of business structures available for the start-up.  The most common forms of business structure are (A) no entity (sole proprietorship), (B) partnership, (C) corporation, and (D) limited liability company.  These structures each have their own unique benefits and burdens.

**Sole Proprietorship**

A. The sole proprietorship is the simplest business structure, since any individual who opens a shop with doing nothing more is an instant sole proprietorship.  The downside, unfortunately, is that the business owner is 100% liable for all of the obligations of the business.

**Partnership**

B. The partnership (general) is also simple to form, because any two or more persons joining together to pursue a business for profit are deemed a partnership, whether or not they intend to form a partnership.  Again, the downside, is that the partners will be completely liable for all obligations and liabilities of the business.

**Corporation**

C. A corporation is a more complex structure, that requires statutory formalities to form (typically the filing of Articles of Incorporation with the appropriate state governmental entity), and following certain formalities (annual reports, shareholder meetings, etc.) to maintain the corporation’s shield against the personal liability of its owners for the obligations of the corporation.

**Limited Liability Company**

D. A limited liability company is a more complex structure, similar to a corporation (must file Articles of Organization to form), but not requiring many of the corporate formalities associated with maintaining a corporation.  This type of entity provides protection for its owners (typically called “members”) from personal liability for the liabilities and obligations of the company.  The members of the company typically enter into an Operating Agreement to set out the rights and obligations of the members.  As with corporations, there will be exceptions to the shield from personal liability, but the risk is far less than with a sole proprietorship or general partnership.

**Tax Matters When Forming a New Business**

The type of entity that you use in forming your business will generally affect what type of taxes the entity, and its owners may pay.  The most common tax matters to consider are (A) Schedule C (individual tax return), (B) partnership return, or (C) corporate return.

A. For a sole proprietorship, everything will be reported on Schedule C to your personal income tax return.  You will need to pay self-employment tax on all income of the entity, and may even be required to make quarterly advance payments.

B. For a partnership, the entity will file a tax return, but the partnership will not actually pay taxes.  Instead, the information will be reported to the IRS, and then the partners will pay the tax on the income of the partnership through their personal income tax returns.   A limited liability company will typically operate this way as well.

C. The most complex taxation would be where a corporation is formed.  A corporation, where no exceptions apply, will typically be double taxed (at the corporation level, and then again at the shareholder level).  The corporation would pay tax on its income, and then the shareholders will pay taxes on the distributions they received from the corporation.  There are ways to structure the corporation to avoid the double taxation, including the filing of a subchapter S Election to allow the corporation to operate as a S Corporation (instead of the double-taxed “C” Corporation), and thus avoiding the second level of corporate tax.

The attorneys at GWC have significant experience representing business owners and other clients in business matters.  Please do not hesitate to contact Tim Gillis at GILLIS, WAY & CAMPBELL with any questions.

Forming a business entity is an important way to protect yourself from liability and save money on taxes. A business entity such as a corporation or limited liability company (LLC) is legally a separate "person" from its owners. Here are some key things to keep in mind when you go about forming a business.

**Filing Formation Paperwork**

To form most business entities, you must file a form with the state agency that handles business filings (usually the secretary of state) along with a filing fee, which varies from state to state. After the state receives and processes your formation paperwork, you'll receive a certificate confirming that your new company officially exists.

In addition, every business entity should have documents that describe the rights and responsibilities of the people who own and operate the company. Although these documents are not filed with the state, they are important guidelines for running your business and can prevent costly conflicts later.

**Setting Up Financial and Tax Accounts**

It's important to keep business and personal expenses separate. Here are some ways to do that:

* Get a federal Employer Identification Number (EIN). Most businesses must have an [EIN](https://www.legalzoom.com/business/business-operations/ein-federal-tax-identification-overview.html), the business equivalent of a Social Security number.
* Open a business bank account. Take your business formation certificate and EIN to a bank or credit union to open a business account. Consider getting a business credit card as well.
* Register with state and local taxing and licensing agencies. You must register with your state taxing authority to pay state taxes, including income and sales tax. Businesses with employees must also pay various employment-related taxes.

**Getting Business Insurance**

[Business entity formation](https://www.legalzoom.com/business/business-formation/) can protect your personal assets if your business is sued, but it can't protect the business itself from potentially devastating losses due to a personal injury lawsuit, fire, theft, flood or data breach. For that kind of protection, you need [business insurance](https://www.legalzoom.com/articles/business-insurance-when-you-need-it-and-when-you-dont). There are several types of business insurance for different kinds of risk. An insurance agent who specializes in small business insurance can help you get the coverage you need.

**Using Contracts to Protect Yourself**

Most small businesses need a basic set of contracts to cover their most common transactions. These might include:

* [Nondisclosure agreement (NDA)](https://www.legalzoom.com/forms/nondisclosure-agreement). Protects the business's confidential information by requiring that people keep information about your business private.
* [Employment contracts](https://www.legalzoom.com/forms/employment-agreement). Provides written employment terms.
* [Intellectual property assignment.](https://www.legalzoom.com/forms/intellectual-property-assignment) Allows the transfer of property rights while protecting the rights of all parties.
* [Terms and conditions](https://www.legalzoom.com/business/business-operations/website-terms-and-conditions-overview.html). Specifies the rules governing the use of a website.
* Written contracts are important because they help avoid misunderstandings and make it easier to enforce an agreement in court.

**Staying Up-to-Date with State Agencies**

Your state's laws may require business entities to keep certain records. These might include meeting minutes, resolutions and ownership records. You may also need to file an annual report and pay an annual fee. The rules vary based upon the type of entity, and from state to state, so consult your state's laws or a business lawyer to learn more about your obligations.

If you will do business in a state other than the one you formed your business in, you must register to do business in that state. The procedure is similar to the one you followed when forming your business, and it may require additional tax and reporting obligations in the other state.

To maximize your protection and avoid tax penalties, always keep personal and business finances separate, observe proper procedures and keep complete and accurate records, maintain adequate insurance, and file and pay taxes on time.