

Business Formation

Forming a business is not a complicated undertaking, however there are steps that need to be taken so that problems do not follow the business in the future that can be avoided by proper formation.

First off determining the type of business and how you perceive it will grow over time is important to selecting the structure of the business entity. A small business with one person who both owns and operates the business may select a sole proprietor status. A business that will own equipment, lease space and hire additional employees or independent contractors to work for the business entity may select a limited liability company status and then have the option of determining the best suited taxing structure for the business with the help of a tax professional. Lastly, a corporation, is the most recognizable business structure and offers benefits that a sole proprietorship or a limited liability company does not. The least expensive and easiest to administrate is the sole proprietor, progressing to the LLC and then a corporate entity.

Structures for Business Entities

- 1. Sole proprietorship**, also known as the **sole trader** or simply a **proprietorship**, is a type of business entity that is owned and run by one individual and in which there is no legal distinction between the owner and the business. The owner receives all profits (subject to taxation specific to the business) and has unlimited responsibility for all losses and debts. Every asset of the business is owned by the proprietor and all debts of the business are the proprietor's. It is a "sole" proprietorship in contrast partnerships. A sole proprietor may use a trade name or business name other than his or her legal name.
- 2. Limited liability** is a concept whereby a person's financial liability is limited to a fixed sum, most commonly the value of a person's investment in a company or partnership with limited liability. If a company with limited liability is sued, then the plaintiffs are suing the company, not its owners or investors. A shareholder in a limited liability is not personally liable for any of the debts of the company, other than for the value of their investment in that company. This usually takes the form of that person's dividends in the company being zero, since the company has no profits to allocate. The same is true for the members of a limited liability partnership and the limited partners in a limited partnership. By contrast sole proprietors and partners in general partnerships are

each liable for all the debts of the business (unlimited liability).

Although a shareholder's liability for the company's actions is limited, the shareholder may still be liable for its own acts. For example, the directors of small companies (who are frequently also shareholders) are often required to give personal guarantees of the company's debts to those lending to the company. They will then be liable for those debts in the event that the company cannot pay, although the other shareholders will not be so liable. This is known as co-signing.

3. **S corporation**, for United States federal income tax purposes, is a corporation that makes a valid election to be taxed under Subchapter S of Chapter 1 of the Internal Revenue Code. In general, S corporations do not pay any federal income taxes. Instead, the corporation's income or losses are divided among and passed through to its shareholders. The shareholders must then report the income or loss on their own individual income tax returns.

An overview of S corporations

S corporations are merely corporations that elect to pass corporate income, losses, deductions, and credit through to their shareholders for federal tax purposes. The S corporation rules are contained in Subchapter S of Chapter 1 of the Internal Revenue Code (sections 1361 through 1379). S status combines the legal environment of C corporations with U.S. federal income taxation similar to that of partnerships.

Like a C corporation, an S corporation is generally a corporation under the law of the state in which the entity is organized. For Federal income tax purposes, however, taxation of S corporations resembles that of partnerships. As with partnerships, the income, deductions, and tax credits of an S corporation flow through to shareholders annually, regardless of whether distributions are made. Thus, income is taxed at the shareholder level and not at the corporate level. Payments to S shareholders by the corporation are distributed tax-free to the extent that the distributed earnings were not previously taxed. Also, certain corporate penalty taxes (e.g., accumulated earnings tax, personal holding company tax) and the alternative minimum tax do not apply to an S corporation.

Unlike a C corporation, an S corporation is not eligible for a dividends received deduction.

Unlike a C corporation, an S corporation is not subject to the 10 percent of taxable income limitation applicable to charitable contribution deductions.

Qualification for S corporation status

In order to make an election to be treated as an S corporation, the following requirements must be met:

Must be an eligible entity (a domestic corporation or a limited liability company which has which has elected to be taxed as a corporation).

Must have only one class of stock.

Must not have more than 100 shareholders.

Spouses are automatically treated as a single shareholder. Families, defined as individuals descended from a common ancestor, plus spouses and former spouses of either the common ancestor or anyone lineally descended from that person, are considered a single shareholder as long as any family member elects such treatment.

Shareholders must be U.S. citizens or residents, and must be natural persons, so corporate shareholders and partnerships are generally excluded. However, certain trusts, estates, and tax-exempt corporations, notably 501(3) (c)

[http://en.wikipedia.org/wiki/501\(c\)corporations](http://en.wikipedia.org/wiki/501(c)corporations), are permitted to be shareholders.

Profits and losses must be allocated to shareholders proportionately to each one's interest in the business.

If a corporation meets the foregoing requirements and wishes to be taxed under Subchapter S, its shareholders may file Form 2553: "Election by a Small Business Corporation" with the Internal Revenue Service (IRS). The Form 2553 must be signed by all of the corporation's shareholders. If a shareholder resides in a community property state, the shareholder's spouse generally must also sign the 2553.

The S corporation election must typically be made by the fifteenth day of the third month of the tax year for which the election is intended to be effective, or at any time during the year immediately preceding the tax year. Congress has directed the IRS to show leniency with regard to late S elections. Accordingly, often, the IRS will accept a late S election.

Some states such as New York and New Jersey require a separate state-level S election in

order for the corporation to be treated, for state tax purposes, as an S corporation.

If a corporation that has elected to be treated as an S corporation ceases to meet the requirements (for example, if as a result of stock transfers, the number of shareholders exceeds 100 or an ineligible shareholder such as a nonresident alien acquires a share), the corporation will lose its S corporation status and revert to being a regular C corporation.

If more than 25% of a S-corporation's gross receipts consists of passive income for three consecutive years when the corporation has accumulated earnings and profits, the S corporation will automatically lose its subchapter S status and revert to being a regular C corporation.

Sales Tax License and Business Entity Registration information must be obtained through the state where the business intends to be formed or operated. You can seek help through the Secretary of State's website in your locale.

Obtaining a federal tax ID number is through the <http://www.irs.gov> website and may be obtained online, through fax or mail.

Google, Yahoo and Bing, as well as others search engines and social media sites like Facebook and Twitter offer abundant resources for businesses to promote and advertise their services and products.

Please let us know if you need more specific direction in these areas through the www.youhaverightstoo.org website