

STARTING A BUSINESS: MISSION POSSIBLE

Entrepreneur ,you have been contacted for your interest in becoming a business owner and operate as an entity rather than a sole proprietorship. Should you decide on proceeding with this venture, you should know that the stress is high, the hours long, the workload often overwhelming, the administration mind-boggling, and your children will be grown up when you get home. Why proceed? Great fun and unlimited success. Good luck in your endeavor!

So you are ready to accept the challenge? Great! Here are a few things you need to decide before you can hang your sign.

Choose the type of entity from which to operate your business. The more common choices are a handful (C Corporation, S Corporation, Limited Partnership, and Limited Liability Company), but the differences in the choices can make you want to self-destruct. Don't panic! Regardless of which entity you choose, the steps to form the entity are relatively similar. First things first: Name your business. Contact the Secretary of State to determine if your chosen company name is available. Each entity has a unique formation document, which must be filed with the Secretary of State. Once filed, you will receive a Charter Number. You will then need to apply to the Internal Revenue Service for a tax identification number (which can now be obtained online within seconds). Once you have a tax identification number, you will be able to open a checking account. Your business entity is now alive and kicking!

C Corporation: In general, most people are familiar with corporations. The formation document is called Articles of Incorporation, and the rules adopted for managing the corporation are the Bylaws.

A corporation is owned by its shareholders who elect members of the Board of Directors whose job it is to oversee the operations. The Directors hire the officers who manage the day-to-day operations. On an annual basis, there must be a Shareholder's Meeting and a Board of Director's Meeting (even if you are the sole shareholder and sole member of the Board).

A C Corporation can have an unlimited number of shareholders. The shareholders are limited in liability to the extent of their investment in the corporation.

For income tax purposes, the C Corporation pays its own income taxes at rates set out in the Internal Revenue Code. Furthermore, if the C Corporation pays dividends to the shareholders, then the amount of dividends received must be included in the shareholder's income taxes. **Take Note:** It is possible for a C Corporation's income to be subject to double taxation - once at the corporate level and again at the shareholder level.

S Corporation: All S Corporations begin as C Corporations. To become an S Corporation, the C Corporation, after its formation, must make an election to the Internal Revenue Service on Form 2553 to be taxed as a Small Business Corporation, causing the corporation to be taxed as a pass through entity. In other words, all items of income, expenses, gains, and losses are passed through to the shareholders and reported on each shareholder's income tax return in proportion to each shareholder's ownership percentage.

There are some restrictions to operating as an S Corporation. Mainly, an S Corporation is limited to 75 shareholders, and these shareholders can not be corporations, nonresident aliens,

partnerships, pension plans, charitable organizations, or most trusts. Also, an S Corporation can have only one class of stock. When there is only one owner, he/she will be the sole shareholder, acting as both President and Secretary, and will be the sole member of the Board of Directors.

Limited Partnership: A limited partnership must have two or more partners, one of whom must act as the general partner. The general partner(s) has several and personal liability, whereas, the limited partner(s) has limited liability to extent of the investment in the partnership. No annual meeting is required.

It is much simpler to form a partnership. It is not required to prepare and file a partnership agreement with the Secretary of State; you simply need an “agreement” between two or more individuals. A handshake, however, is not a prudent way to conduct business. A properly prepared partnership agreement details what is expected of each partner and what each partner should expect in return.

Similar to an S Corporation, a partnership is taxed as a pass through entity. The biggest advantage to operating a partnership in Texas is that it escapes the Franchise Tax, which is the state corporate income tax.

Limited Liability Company: A limited liability company encompasses the best characteristics of the corporation, partnership, and sole proprietorship. It is a separate legal entity with limited liability like a corporation, but it is taxed like a partnership. It can be owned by an unlimited number of members, and its rules of operation are adopted in the Operating Agreement. No annual meetings need be held. If there is only one member, then for state purposes, the entity is valid and the member is afforded limited liability, etc., but for federal income tax purposes, the entity is disregarded and the member reports the business’ financial activity on Schedule C of the member’s individual income tax return.

Creating your business entity is not only possible, it is relatively easy. Whatever your choice, consider long-term goals, the industry, employee benefits, growth opportunities, limits to liability, and opportunities to lessen the tax burden.

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This Article should NOT be taken as legal, tax, or financial planning advice for your own particular situation. Instead, you should consult with a qualified professional to seek such advice.