Business Structure
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Question: I am starting a business and need to know what business structure I should use. My CPA tells me I should incorporate.

It is important to select an appropriate business structure to meet the needs of the business and the owner. Making the wrong decision can result in personal debt, liability, additional taxes, loss of public benefits, additional operating costs, and high tax preparation fees. Determining the share of ownership and making a good decision on the business structure can avoid many future problems.

There are basically five types of business structure. There are advantages and disadvantages to each.

1. *Sole Proprietor* – The easiest way to form a business is as a sole proprietor. The business owner and the business are essentially the same. There is no need for legal documents and there are no filing requirements other than the Schedule C in the individual tax returns. A sole proprietor does not even need a federal employer ID number, but can do business under the individual owner's Social security number. The disadvantage to this structure is that the owner is personally liable for the business. If the business is sued, it is the owner that is liable. If things don't go well and the business goes bankrupt, it is a personal bankruptcy. Changing ownership of the business can also be more difficult than with other structures.

2. *Partnership* – Partnerships are used when more than one person is involved in the ownership of the business. The partners share in income and expenses based on their percentage of ownership share in the partnership. Before beginning a partnership, it is a good idea to create a written partnership agreement which identifies the responsibilities of each partner. Legal liability in a partnership is the same as for a sole proprietor. If the business is sued, it is the owners that are liable. If things don't go well and the business goes bankrupt, it is a personal bankruptcy for the owners. Changing ownership of the business can also be more difficult than other structures.

3. *Sub S Corporation* – A Sub S Corporation is treated like a partnership for taxes, but creates a separate legal entity. It can protect the owner personally from suit or bankruptcy. The ownership is in the form of shares, so ownership can be transferred more easily. There are state filing requirements with this type of structure, and there may be state taxes that will need to be paid. Some employee benefits, such as health insurance are not deductible expense for income tax purposes. Options for retirement plans are somewhat limited. Minutes of

meetings must be maintained with at least one shareholder meeting per year. Major changes in the business must be supported by resolutions. This is a favorite structure of CPA's and is often recommended. It is a corporation, and as such tax preparation fees are usually quite high. Legal protection for the owners is only effective if there is no mixing of personal and corporate money and assets. A Sub S Corporation is usually formed with the aid of an attorney and/or accountant. Some forms of public benefits, such as SSI, do not look favorably on any type of corporation.

4. *C Corporation* – A C Corporation is a standard corporation and most large businesses use this structure. C Corporations provide good liability protection for the owner(s); however a C Corporation is seen as a separate entity and is taxed as such. This can result in double taxation. The corporation can pay taxes on income, then the owners pay taxes on distributions they receive. The ownership is in the form of shares, so ownership can be transferred more easily. There are state filing requirements with this type of structure, and there are federal and state taxes. Minutes of meetings must be maintained with at least one shareholder meeting per year. Major changes in the business must be supported by resolutions. Legal protection for the owners is only effective if there is no mixing of personal and corporate money and assets. A C Corporation is usually formed with the aid of an attorney or accountant. Some forms of public benefits, such as SSI, do not look favorably on any type of corporation

5. *Limited Liability Company (LLC, PLLC)* – An LLC is the newest form of business ownership. It is a registered unincorporated entity. It gives the same legal protection as a corporation, but without as much of the reporting and taxing requirements. Legal protection for the owners is only effective if there is no mixing of personal and corporate money and assets. An LLC can be set up to function like a sole proprietorship, partnership or Sub S Corporation. There is generally some level of state reporting which varies state by state. While there is some expense in setting up an LLC, the fees are generally less than setting up a corporation or getting a partnership agreement prepared. Each state has certain requirements for setting up and maintaining an LLC. The person creating the LLC can give you the specific state rules

Under certain circumstances each business structure has advantages. There are occasions when each structure may be preferable over another. An LLC is the most flexible structure which affords legal protection to the business and owners, however there are implications for Social Security beneficiaries which need to be understood.

Social Security has released a statement in which they have determined that they will treat ownership in an LLC as a resource to an SSI beneficiary. Based on a determination, an SSI beneficiary may use an LLC and include the LLC as PESS for the duration of a PASS if the business liability would require a significant level of insurance or would include potential significant personal liability risk for the beneficiary.


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