CHOOSING THE RIGHT ENTITY FOR YOUR BUSINESS

Starting a new business is an exciting — and somewhat daunting — endeavor. You've got a lot of planning to do, a lot of paperwork to fill out, and a lot of questions to ask yourself.

The answer to one of those questions will have a significant impact on your taxes. Specifically, what kind of business entity should you establish? Whatever form of business you choose will ultimately determine which income tax return you'll need to file.

To make the process a little simpler, we put together this guide. If at any point in your business's journey you need help, don't hesitate to reach out to us: **www.caseypeterson.com/contact-us**

ENTITY DESCRIPTIONS

These are some of the most common types of businesses:

- Sole proprietorship
- Partnership
- Corporation, often called a C corp
- S corporation
- Limited Liability Company, usually referred to as an LLC

1 SOLE PROPRIETORSHIP

If you opt to designate your business as a sole proprietorship, that means you own an "unincorporated business" by yourself. With an unincorporated business, you, as the owner, are responsible for all business results. In a sole proprietorship, the IRS doesn't distinguish between you as a taxpayer and your business.

However, it is a little different if you're the only member of a domestic limited liability company, which we discuss in more detail below. In short, you can't be a sole proprietor if you decide to treat the LLC as a corporation.

If sole proprietorship is right for your business, the IRS has a list of forms you'll need to choose from for your taxes. You can find them at **https://bit.ly/SoleProprietorTaxForms**

2 PARTNERSHIP

In a partnership, two or more people share ownership of an unincorporated business. Each member of the partnership contributes something — whether that's money, labor, skill, etc. — and shares in the business's profits and losses.

To see what forms you'll need if you decide to form a partnership, visit **https://bit.ly/BusinessPartnershipTaxForms**

3 CORPORATION (OR C CORP)

"Shareholders" are the owners of a corporation. When shareholders form a C corp, they provide money, property, or both in exchange for capital stock in the corporation. However, not all entities that are C corps are publicly traded.

When it comes to federal income taxes, the IRS recognizes C corps as separate taxpaying entities. Under this structure, the corporation conducts business, realizes profit or loss, pays taxes, and provides any profits to shareholders.

There's a kind of "double tax" when it comes to corporations. First, the IRS taxes a corporation's profit. Then the agency taxes shareholders' dividends. C corps don't get a tax deduction when they distribute dividends, and shareholders can't deduct any of a corporation's losses.

To see what forms the IRS requires of corporations, visit **https://bit.ly/CcorpTaxForms**

4 S CORPORATION

S corps are corporations that pass income, losses, deductions, and credits to their shareholders for federal tax purposes.

S corp shareholders report the income and losses on their personal tax returns, and the IRS taxes them at their individual income tax rates. In this way, S corps avoid the double tax that C corps face. As with C corps, not all S corps are publicly traded.

For your business to qualify as an S corp, it:

- Must be a domestic corporation
- Must have only allowable shareholders who:
  - May be individuals, certain trusts, and estates, and
  - May not be partnerships, corporations, or non-resident alien shareholders.
- Must have no more than 100 shareholders
- Must have only one class of stock
- Must not be an ineligible corporation (i.e., certain financial institutions, insurance companies, and domestic, international sales corporations).

To become an S corp, there's a form you have to fill out and have all your shareholders sign. You can see all the details at **https://bit.ly/ScorpFormsAndInstructions**

5 LIMITED LIABILITY COMPANY (OR LLC)

LLCs are business structures that each state determines. As such, if you're considering forming an LLC, you should check with your state to find out what its requirements are. Typically, banks and insurance companies can't be LLCs, and there are special rules for foreign LLCs.

LLCs usually protect your personal assets. For example, if your business faced a lawsuit or bankruptcy, you wouldn't lose your home, car, savings, etc.

Most states don't restrict who or what can own an LLC. So, owners — usually called members — might be individuals, corporations, other LLCs, and foreign entities. There's no maximum number of members, and LLCs can also just have one owner, called a "single member."

Depending on the type of LLC and how many members it has, the IRS will treat it as a corporation, a partnership, or as part of the LLC's owner's tax return. An LLC with at least two members is a partnership, unless the members fill out the correct forms and opt to be classified as a corporation.

The IRS treats single-member LLCs as an "entity disregarded as separate from its owner." That's unless the LLC files the right form to be considered a corporation. But for employment taxes and certain excise taxes, the IRS still considers a single-member LLC a separate entity.

If you want to form an LLC for your business, you can find the forms you need at:
https://bit.ly/LLCtaxformsandinstructions

You can also see what your state requires for LLCs here:
https://bit.ly/StateGovtTaxSite

LESS COMMON ENTITY TYPES

BENEFIT CORPORATION (OR B CORP)

B corps are still for-profit companies, though not all states recognize them. However, there is a certification process B corps can go through. Their purpose, accountability, and transparency are different from those of a C corp. But the IRS taxes them both the same.

The biggest difference between a B corp and a C corp is that B corps are focused on a mission as well as a profit.

In a B corp, shareholders hold the company accountable for creating a public benefit in addition to a profit. In some states, B corps must submit annual "benefit reports" that show what they've contributed beyond the money they've made.

CLOSE CORPORATION

Close corporations are similar to B corps, but their structures tend to be less traditional. They're usually not as formal as typical corporations and are often smaller companies. A small group of shareholders without a board of directors can run a Close corporation, and usually, states don't allow their shares to be publicly traded.

NONPROFIT CORPORATION

Nonprofit corporations — often called 501(c)(3)s because of their IRS code — have to do work that somehow benefits the public. Nonprofits could be charities, educational institutions, religious organizations, or even literary or scientific organizations.

Corporations with a nonprofit status don't have to pay state or federal taxes on their income or profits. However, they do have to follow special rules about how they spend any profits. For example, they can't give profits to members or political causes.

COOPERATIVE

A cooperative is a business or organization that those using its services own and operate. So, any profits a Cooperative makes go directly to its members. There's usually a board of directors and officers who run the Cooperative. Regular members vote to determine the direction the Cooperative takes.

STRUCTURES VS. TAX STATUSES

Designations like S corp and nonprofit can be both a business structure and a tax status. An LLC might be taxed as an S corp, or a C corp, or even a nonprofit. However, those designations aren't common and can be challenging to set up. If you're considering a structure that's not a standard one, check with a business advisor or lawyer to make sure you're doing everything correctly.

If you have questions about the different business types and which one is right for you, reach out to us!

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