The ABC's (and LLCs…) of Structuring a Business
By William Russell, CPA

Making the decision to start a new business venture can be exciting. Though often the culmination of a long-time vision and months or even years of research and planning, still, it's essential to slow down and focus on the details as well.

While you may know exactly what your new widget will look like and you might have grand plans for hitting the streets with this jewel, it's essential to start any new business venture with the appropriate framework. In setting this up, a first and very important decision should be how the entity will be structured. Are you an 'S' Corporation, Partnership, or 'C' Corp? Should you form an LLC? And what does all of that really mean?

It's important to recognize that tax and business laws are constantly changing and that one structure definitely does not fit all circumstances. Therefore, following the advice of an attorney *and* accountant experienced in setting up a business is key. One structure may offer legal protection while another yields better tax benefits for your situation, so it's important to carefully review the legal and financial ramifications of each option.

Here are a few factors to consider…

A single owner may structure a business as a **sole proprietorship**, though this at times is not recommended, in part due to the pass-through of liability on business debts and actions. Yet, in comparison to other options, there may be a few advantages to the owner, including the ability to file one personal tax return and thus avoid the need for a separate return for the business. One way to limit the liability for a sole proprietorship is to form an LLC.

An **LLC** (or **limited liability company**) is a liability-limiting entity formed under state law that offers the benefit of asset protection to owners or shareholders. For taxation, however, it is treated as a "disregarded" entity for federal income taxes and can be taxed under any of the following tax classifications. It is primarily used for legal protection of the shareholders, and its tax consequences need to be determined independent of the LLC designation.

A **partnership** is an organization with two or more owners that functions as a trade or business. An LLC with two or more members is generally classified as a partnership for tax purposes. One contrast from the sole proprietorship is that this creates the need for a separate tax return.

A corporation may be taxed as an **'S' corporation,** if they only have one class of stock and there are less than 100 shareholders. In this case, the taxation is similar to a partnership, where income and expenses flow through to shareholders. Likewise, losses flow to the shareholders in an 'S' corporation or partnership. This can be advantageous in the early years of a business, especially when individuals have taken on significant financial burdens to get a business started. Although the IRS does not recognize this as a reason for establishing an S corporation, there can be tax advantages on distributions to shareholders in this situation.

A **'C' corporation** is a business entity that carries its own legal status and is a separate and distinct taxable entity from its owners. Typically used for larger corporations with varying classes of stock, this is inherently a bit more involved to set up. In this instance, the corporation pays taxes and carries all legal liability.

So which one is best for you? There's a confusing maze of legal and financial considerations, no doubt, and one size does not fit all. Some of these options address legal issues, while others offer tax advantages, and they can be combined or organized in different ways.

It's good to have a working knowledge of the options before sitting down with your financial and/or legal counselor, and there are several no-cost resources out there, such as SCORE and the SBA, among others.

However, in the end, it's strongly advised that you tap the resources of trained and seasoned professionals and explore the best structure for your specific situation. The expenses can pile up when starting a business, so it's tempting to forego some costs here and there, but the expenditure for good advice on the front end may save you millions on the back end. And it's the lure of that first million that got you here to start with, right?

Will Russell is a principal with Jarrard, Nowell & Russell, a certified public accounting and business advisory firm based in Charleston. Will can be reached at (843)723-2768 or wrussell@jnrcpas.com.