Considerations when selecting a business entity type

Sole Proprietorship

- Business owned and operated by one person. This person pays personal income tax on profits earned from the business. The owner receives all of the profits and are also liable for any and all losses.

- They are easy to start and dismantle due to the fact that these business structures are unincorporated businesses and only have one owner.

- One main disadvantage of sole proprietorships is all liabilities extend from the business to the owner. This is due to the fact that they are not registered as a separate legal entity. Therefore, all business – and personal – assets are eligible and available to satisfy any and all liabilities of the sole proprietorship.

- Pros:
    - Little required paperwork
    - No need to obtain an EIN from the IRS (unless planning to have employees)
    - Quick & easy to set up as compared to other business structures
    - Pass-through tax advantage (you pay tax on the net profits of your business within your individual tax return)
- Cons:
    - Unlimited liability
    - No separation between your business and personal assets
    - Pay self-employment tax on all net income from business
    - More difficult to raise capital

- How do you start a sole proprietorship?
    - Select business name
    - Register the name with the MN Secretary of State (or similar other state body) – as an assumed name – *cost of filing an assumed name with MN SOS is $55*
    - Permit/license requirements – need to be met, if applicable
    - Obtain an EIN (if planning to have employees) and obtain a sales tax ID, if needed

Limited Liability Company (LLC)

- An LLC is a limited liability company, which is a business structure that offers limited liability protection and potential pass-through taxation. An LLC can have one owner (known as a "member") or multiple members.

- These business entities legally exist as a separate entity from its owners.

- Cost of establishing an LLC with the MN Secretary of State is $155.

- Owners share the profits and potentially the tax liabilities, too. The tax impacts of an LLC depend on how the entity elects to be taxed.

- LLC's can be taxed as one of the following:

- Single-member LLC – these LLC's have only one member/owner – these entity types are considered to be "disregarded tax entities" by the IRS. Therefore, these entity types are taxed the same as a sole proprietorship.
- Partnership entity – by default, if an LLC has two or more members, the LLC will be taxed as a partnership entity.
- S-corporation – if an LLC files an election with the IRS to be taxed as an S-corporation, the LLC would be taxed as an S-corporation.
- C-corporation – an LLC could file an election to be taxed as a C-corporation.

  - All of these create different tax benefits and consequences. But, the takeaway here is LLC's have a lot of flexibility on how the income and deductions are taxed for such entities.

- Pros:
  - Limited liability – members of an LLC are generally protected from personal liability, meaning individual creditors generally cannot pursue a member's personal assets to satisfy debts.
  - Flexible membership – able to have one member/owner or multiple members/owners
  - Heightened credibility – starting an LLC may help a new business establish more creditability than if the business is run as a sole proprietorship.
  - Pass-through taxation – the member(s) have options on how best to structure the taxability of the income and deductions of the LLC to minimize tax liabilities.

Corporation

- This type of business entity is a legal entity that is separate from its owners. The cost to form a corporation is higher than other structures, however, it typically provides the strongest protection for owners from personal liability.

- C-Corporations are taxed as a separate entity and pay any generated tax liabilities annually.

- C-Corporations are generally known as entities that are taxed twice. First, on the business net profit and then stockholders must pay personal income tax on the dividends paid from the company's profits. The corporate tax rate is a flat rate of 21%.

- Provide limited liability – Shareholders and owners will not be held responsible for debts and obligations that extend the original amount of their investments.

NOTE:

- We get this question frequently: I would like to organize my business as a S-corporation – how do I go about that?
  - An S-corporation is technically not a legal entity – it is a *tax designation*. To achieve having your business entity *taxed* as an S-corporation, you must first organize your business entity as either a Limited Liability Company or a Corporation – and *then* file the election to be *taxed* as an S-corporation.