



I'm starting a business...now what?



First, congratulations on your new venture! This is an exciting transition. It's a long road ahead, but we are here to help. This guide is based on the most common issues that our clients ask when starting out.

First, some basics: What type of business structure should you choose?

Choosing how to structure your business is incredibly important from a liability and tax perspective. It also can affect the way your business is eventually sold.

What kinds of business entities are there?

In short- many!

First, let's clarify that there are **tax** designations and **legal** designations for any business.

The most common **tax designation** examples are:

Sole-proprietor, partnership, corporation (S-election or traditional C-Corp) and non-profit association or corporations. The way that you and your business are taxed will depend on these elections.

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When you start a business on your own, the “default” tax type is sole-proprietor and you will file your business tax information on a Schedule C on your Federal 1040. While you won't receive a paycheck- all money withdrawn reduces your equity as an owner draw- you will be paying self-employment and federal and state income tax, based on your net income from this business. So, tax planning and recordkeeping will be very important. Estimated tax payments will be due **each quarter** that you are in business.

If you and one or more of your friends begin a business together, your “default” tax status will be a partnership. This means **you will be required to file both a 1065 Partnership tax return** and report your share of the profit, loss, guaranteed payments and distributions from the partnership on a **K-1** that you will then include on your **1040 individual return**. The Partnership return can become very complex as your accountant will need to help you track and determine partnership “basis” year to year and record any changes in ownership interests.

You can also choose to incorporate your business as a C or S-election Corporation. **In a traditional “C” corporation, that would mean that you could offer private or public stock shares to investors.** This form of business requires meticulous recordkeeping as you are not only responsible to governing bodies, but also to your shareholders. In this entity, **the corporation is taxed directly on the 1120 Corporate Income Tax filing**, instead of the income being taxed on your return, as is the case with the sole proprietor or partnership. The tax rates range from 15-39%, based on net income.

Another option is the **S-Corporation** election. You can choose to be filed directly as an S-Corp or as an LLC taxed as an S-Corp (LLCs are covered later under legal designations). Unlike the C-Corp, an S-Corp is restricted in the number and type of shareholders it may have:

- It can have no more than 75 shareholders
- Only individuals, estates, certain trusts, certain partnerships, tax-exempt charitable organizations, and other S corporations (but only if the other S corporation is the sole shareholder) may be shareholders.

The S-Corp is also taxed differently. In this case, the S is a pass-through entity like a partnership, so while **you will file an 1120-S Income Tax informational return, the income will be taxed on your (and your other shareholder's) personal 1040 Federal return** based on the K-1 that shows your share of the profit, losses and distributions. **You may also receive a salary and a W2 from the S-Corp, unlike in a partnership or sole-proprietorship.**

Perhaps you've chosen a non-profit model? These organizations have very specific rules as they are treated as public entities that must meet many legal considerations. There is a lot of legal and accounting paperwork involved, and we could fill a large volume on this matter. We recommend making an appointment with us for our non-profit consulting to review the intricacies of these organizations.

So how do you choose? We always recommend a consultation with your accountant before you choose a filing status as these decisions have many complexities- including your lifestyle, goals and income requirements.



Legal designations and requirements

Legal entities include LLCs, LLPs, PLLCs. For certain professions, there are regulations as to the type of **legal business structure** you may have (ex. Medical professionals, mental health professionals, accountants, attorneys, land surveyors). In other cases, you may choose an LLC format for particular legal protections they afford. These entities are often chosen for real estate holdings as well for the protections that they afford.

The legal entity may not have anything to do with how you are taxed, or it may, it all depends. For example, you could be a LLC and elect S-Corporation treatment for tax purposes or be a partnership for tax purposes.

Once the legal designation is chosen, you will need to file Articles of Organization in any state in which you will be conducting business and have employees. You will also need a registered agent in each of these states. Some states also require additional licensing, depending on the industry.

You will then need to register with several government entities for payroll, sales and use and excise taxes. These include Department of Revenue for the states in which you operate, the Employment Security Commission in states where you have employees, and the IRS. Your accountant can help you with these filings.

Depending on the type of legal structure you choose, you will need file an annual report with the Secretary of State in each state in which you are registered and may have some additional privilege license fees to pay annually. Often, your accountant will help with this filing when your business tax return is prepared.

We recommend you meet with an experience business attorney to discuss the legal classifications you are considering, but be sure that your accountant and attorney are on the same page with whatever you decide!

These decisions are in many ways the most important business decisions you will make. The complexities in the law and tax strategy are the reason it is so important to create and meet with your “support team” before you make these decisions. Your support team will include your accountant, a business attorney, a liability and health insurance agent, and eventually a financial advisor.

Do you want to know more? Schedule a new business appointment with us to review your options.