Legal Business Structure Options for Clients

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> Scenario 1
> Karen and Alex have worked together to create a concept to form a website development company. To do this, they have asked three associates to invest their own money in the business in return for receiving a percentage of the profits. The three investors will not need to be involved in any of the day-to-day management or conducting of business in the proposed company.

For this scenario, the recommended legal business structure is an S Corporation. Karen and Alex are looking to have a way to give fractional shares of their corporation to their three associates in return for investment capital. Likewise, there will be no requirement that they be involved in any aspect of the corporation's management or conduct business in the company. Under an S Corporation filing this will be completely possible. Since they doesn't intend to publicly trade shares or have an initial public offering, they can choose the sub S Corporation (Entrepreneur, 2020). Both Karen and Alex will have protection from liability in the event of any claims by business creditors from either poor business deals leading to litigation or claims arising out of contractual issues (Wolters Kluwer, 2020). In the spirit of being advised as to all adverse provisions and limitations, it should be considered that under an S Corporation filing, all owners must be individuals and not another corporate entity. Additionally the owners are required to be U.S. Citizens. Finally, Karen and Alex will be limited to just one class of stock.

Karen and Alex should search for a suitable name for the company and check the Department of State's records in the state where they intend to incorporate to make sure that the name desired is not already in use and that there are not any similarly named businesses in the same industry. Karen and Alex will have to be sure that the word Inc, Incorporated, Corp, or Corporation is at the end of their business name. They will have to create articles of incorporation or, if they're not too picky, allow the Department of State to automatically generate one upon application for incorporation. The IRS will need to be contacted to generate an employer identification number. This number will be used when filing taxes, paying employees, and when opening a bank account.

Business profits and itemized business deductions will pass through to the personal IRS tax returns of Karen and Alex rather than being taxed at corporate taxation levels as high as 21% (Wolters Kluwer, 2020). In this way, they will be able to avoid a double taxation. Additionally as owners, they can take an officer's dividend in lieu of standard payroll on a portion or all of their salary to obtain huge tax savings on all of the state and federal taxes which typically get removed from paychecks, e.g. Medicare and Social Security (SmartAsset, 2020). Their S Corporation can easy be converted into a C Corporation should the company grow and need the ability to publicly trade company stock. Under an S Corporation filing, the owners will have protections from liability provided the company has been adequately capitalized (Wolters Kluwer, 2020). I am not sure how Karen and Alex have been handling their finances up until this point, but they should not comingle personal assets with the business assets from this point forward.

> Scenario 2
> A few years ago, Anika started a skateboard company called Wheels Up and she has run it as a sole proprietorship. Wheels Up has operated successfully, creating a sizable workforce and management team; however, a market opportunity has surfaced that could create significant and sustainable growth. Anika wants to change the structure of her business. She is in negotiations with venture capitalists who are interested in investing in the company. She also has two employees, Sandra and Geoff, who are so integral to the company that she wishes they had more of a stake in it.

For this scenario, the recommended legal business structure is a C Corporation. Anika is seeking to upgrade her sole proprietorship to a corporate structure more appropriately aligned with her sizable workforce and management team. A C Corporation will be the best fit for her for several reasons. Firstly, because of the liability protections a corporation affords, her personal assets will be protected provided she has adequately capitalized her corporation or purchased adequate liability insurance to offset any lack in finances. She foresees significant and sustainable growth in her near future and a C Corporation can be owned by any person or entity. This is crucial should she receive an offer to sell her company to another corporation. The venture capitalists she is presently in discussion with can be sold shares in her corporation offering them a fractional ownership interest without any performance requirements as well as the potential to receive dividends if Anika realizes substantial profits. Her two employees Sandra and Geoff can finally own a fractional share and interest in the company which they have been so integral in building. Whilst it is true she will suffer what has become known as double taxation, the Tax Cuts and Jobs Act of 2017 has capped C Corporation taxes at 21%, thus making her tax-liabilities calculable (Nav, 2020). Still, a modest accommodation to ensure that she alone does not have to suffer the burdens of company profits rolling into her personal tax return as taxable income. No doubt, her business is quite profitable and corporate tax levels will be significantly lower than what tax bracket this would place her in if she were an S Corporation with the income being passed down to her personal tax return.

Anika will need to search the Department of State records in the state she intends to incorporate in to ensure the name she desires to use is not already in use. She will need to append the term Inc, Incorporated, Corp, or Corporation to her business name. She will have to either create Articles of Incorporation or fill out the requisite Department of State form to have one automatically generated for her. She will have to register with the Internal Revenue Service to have an Employer Identification Number (EIN) created for her to file taxes under. This same number will need to be used, along with a copy of the filed articles of incorporation, to open a bank account

She will be required to pay annual dues to the Department of State and file annual business reports. Anika will be required to file IRS form 941 quarterly to report federal taxes. She will also be required to file IRS form 940 annually to report federal unemployment taxes (Internal Revenue Services, 2020). The internal revenue service will require Anika to report wage information for her employees on an IRS form W-2 annually. The W-2 form will also report the amount of federal and state (as well as other taxes) withheld from paychecks. IRS tax forms will have to be filed annually for the corporation and income taxes could be up to 21%. Provided her corporation is adequately capitalized, she will not have to worry about personal liability should any accident or injury occur which involves her company. She will need to pay herself a wage as company and personal assets should not be comingled from this point forward.

> Scenario 3
> George would like to start a landscaping business and call it Landscaping by George. The business would require the use of heavy equipment, a large truck with a hydraulic lift, and an open trailer. Because of that, he is fearful of causing an accident and getting sued. He is mainly concerned about reducing the risk of losing his house and other personal assets because of something that happens with the business.

For this scenario, the recommended legal business structure is a limited liability corporation. George is primarily concerned with reducing his risks and ensuring that his personal assets are protected regardless of the disposition of his business venture. For George, the limited liability corporation (LLC) offers the most effective protections for his personal assets and his investments in his business (Huston, 2020). Since his business will require the use of heavy equipment and a large truck with a hydraulic lift, not to mention an open trailer, he needs to ensure that his business is adequately capitalized or else in a case of injury or a serious accident any efforts to be behind a corporate limited liability structure will be in vain (Ungerlaw, 2008). If he is unable to adequately fund and capitalize his business, he can always cover this requirement by obtaining liability insurance, perhaps for a million dollars, and then cover that with an umbrella liability policy of say five million dollars which would kick in and payout for any accidents or injury or death where the liability exceeded the million dollar base policy. Limited liability corporations are permitted as a business structure by state statute. George will need to be fully abreast of the particulars in the state he intends to file in (Federal Internal Revenue Service, 2020).

George will need to select a name for his corporation. He will need to have articles of incorporation drawn up and filed with the state. Some states may require that a limited liability company application accompany the articles (Incorporate.com, 2020). George will need to designate a resident agent for all corporate filings. Many online filing assistant services provide an agent who is a resident in the state one desires to register in. He will need to research applicable business licenses and permits as may be relevant to his business to operate legally. In Florida, the Department of Business and Professional Regulation (DBPR) is the go-to source for information about applicable licenses and permits. Some states additionally require a statement of information form be filed accompanying the articles of incorporation that will set forth a listing of any business partners and the business mailing or primary address of operation (Incorporate.com, 2020).

After George has his limited liability corporation established, he will be required to file yearly LLC update forms and pay the state's renewal fee. Depending on the requested taxation classification, certain IRS forms will be required, including form 1065 and 8832 (Incorporate.com, 2020). In an effort to maintain George's liability protections, it is crucial that he create a designated and separate business bank account and use it exclusively for business. It is further essential that he not comingle his personal and business assets. He will need to apply for an employer identification number with the IRS and also handle obtaining the liability insurances (base and umbrella policies) as previously disclosed.

> Scenario 4
> Jose has started a website where he sells products that he designs and produces himself, such as T-shirts, coffee mugs, bumper stickers, and other similar items. He wants to create a business based off this website and is hoping to do so in the least complicated way possible.

For this scenario, the recommended legal business structure is a sole proprietorship. This corporate structure decision for Jose is an easy one. He requested a method to create his new business in a way which would be the least complicated. The sole proprietorship is that way. The sole proprietorship structure places Jose in sole and complete control of his business. His business assets and liabilities will not be separated from his personal assets and liabilities. He will not have to establish a credit profile or new history under an EIN (employer identification number) because his social security number will be used by creditors if he ever sought a loan from the bank. Unfortunately he will not have an easy time raising money if he desired since he will not be able to sell stock in his company (US Small Business Administration, 2020). However, fortunately his business type does not require much capital and has little financial barriers to entry. The sole proprietorship is a simple and affordable unincorporated business structure. Jose will surely enjoy not having to file ABR (annual business reports) or separately account for business finances with a separate annual business tax return.

Jose can establish his sole proprietorship without the necessity of filing any legal documents with the Department of State in most states. However, if he wishes to operate under a name that does not include his full legal name, he will need to establish a fictitious name registration with the Department of State. While most businesses require obtaining licenses, permits, or clearances, his particular ventures will not require any of these. He may, however wish to trademark, copyright, or patent any catchy phrases, logos, graphics, designs, or concepts he creates which are unique. For now he won't need an EIN, but if he chooses to hire employees, he will need to apply for an employer identification number (Nolo, 2012). His business ventures don't appear to be such that would require any form of general liability insurance, so all that is left for Jose to do is to open a bank account for the fictitious name once he eventually decides on one.

It should be noted that Jose's business is a simple one. It is also in an unregulated industry and as such he will not be required to obtain licenses, permits, or clearances. He will not be required to obtain an employer identification number until he either hires employees or decides to obtain a fictitious name registration to operate under a name other than his legal name. Unfortunately he will not have any shield or veil from liability, however it is fortunate that his business ventures don't appear to require any such protections. Jose will not be required to file a separate tax return, he will file through his normal IRS form 1040 personal tax return (IRS, 2020).

If he elects to operate under a fictitious name registration he will need a separate bank account, otherwise he can use his personal bank account.

> Scenario 5
> Deborah owns a bakery that is best known for her specialty cupcakes. Her most important ingredients are the gourmet chocolates Theo produces in his candy shop. They would like to form a business structure together that helps them to market both of their brands and make consumers aware of the importance of the relationship of their products.

For this scenario, the recommended legal business structure is a partnership. Deborah makes specialty cupcakes. Theo makes gourmet chocolate. The two of them will form a great partnership together. A partnership is a super simple business and filing structure for the two of them to enter into (US Small Business Administration, 2020). A benefit of this structure is that both Deborah and Theo will share in the limited liability that the partnership formation offers. They can jointly contribute in initial capital for their joint business venture, in inventory, and property which can be jointly shared by the business and in the input of their labor and skill while enjoying, jointly, the profits of the business. Another benefit Deborah and Theo will share is the taxation savings. The business will not have to pay any income tax. The profits will simply pass through to each on their individual tax returns (Internal Revenue Service, 2020). If one makes significantly more money than the other from other ventures, there will be no tax burden on the other. Payroll will be greatly simplified and W-2 and 1099 tax forms will not be required for either partner. This is an important positive to note because all income will be reported through an IRS Schedule K-1 form and will permit each to be able to claim not only their share of the partnership's income gains but each will be able to share in credit for deductions and should the partnership reflect a net loss for the year, this will work to their benefit to decrease taxable income figures (Hall, 2015). An important negative to consider when deciding to form this partnership is that neither Deborah nor Theo will be solely in control of the direction of their business but will be making joint decisions and often times differences in opinions can lead to disagreements amongst even the closest of friends. In a way, if comparison is sought, it could be said that a partnership will be a lot like raising a child together.

Creating the partnership for Theo and Deborah can be simplified to six essential steps. Firstly, although it may seem obvious, they must agree on any other partners which they may or may not be bringing on board from the onset of the formation of their partnership. Secondly, they should decide on either a limited liability partnership (LLP) or a limited partnership (LP) (The Balance Small Business, 2020). These legal considerations will be discussed more in depth in the next paragraph. Thirdly, they'll need to decide on a name for their joint business venture. Careful attention should be paid to ensure that the name or similar variants are not already taken and in use. Fourth, they'll need to register their partnership with the state. In Florida, this can be done from Sunbiz.org at the State of Florida, Division of Corporations website. Fifth, they'll need to obtain an employer identification number from the Internal Revenue Service. Lastly they will need to create a partnership agreement. Since neither is by technicality, in sole control, of the direction of the partnership, it would be wise to agree in writing to the general direction for the new partnership.

There are a couple legal considerations which must be addressed. As to personal liability, it is recommended that Deborah and Theo form, what is termed, a limited liability partnership. This will ensure that both individuals' assets are protected and kept separate from the business' assets. Both will thus be protected from the debts of the partnership (US Small Business Administration, 2020). For the particular business these two will be forming, an LLP will be more prefered than a limited partnership such that no one person is seen as having general liability and neither is more vested than the other. As previously discussed, IRS form W-2 and 1099 will not be used since profits and losses will be passed on to the partners in equal apportionment which will either increase or decrease each member's taxable income as reported in their personal tax returns, as well as, profit distribution (Tony Robbins, 2019). Tony Robbins, a life and business strategist, says there are several things each partner should look for in the other, that is: that the other is solutions oriented, has no hidden financial situation that would threaten a successful union, has similar values, is willing to sign a partnership agreement agreeing as to the general direction of the partnership, communicates well, and has similar work ethic (Tony Robbins, 2019). If the other is lacking in any of these areas or considerations, it could pose severe problems to the future success of the endeavor.

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