

Should You Incorporate Your Business?

One of the first decisions you face as a new business owner is whether or not to incorporate the business. The biggest advantage of incorporating is limitation of your liability. Your responsibility for debts and other liabilities incurred by a corporation is generally limited to the assets of the business. Your personal assets are not usually at risk, although there can be exceptions to this general rule. The trade-off is that there is a cost to incorporate and, in some cases, tax consequences.

Should you incorporate? You might not need to incorporate. Depending on the size and type of your business, liability may not be an issue or can be covered by insurance. If so, you could join millions of other business owners and operate as an unincorporated sole proprietor.

If you do decide to incorporate, you will face a choice of corporate forms. All offer limitation of your liability, but there are differences in tax and other issues.

C corporation. The traditional form of corporation is the C corporation. C corporations have the most flexibility in structuring ownership and benefits, and most large companies operate in this form. The biggest drawback is double taxation. First the corporation pays tax on its profits; then the profits are taxed again as they are paid to individual shareholders as dividends. S corporation and LLCs. Two other forms of corporation avoid this double taxation: S corporations and limited liability companies (LLCs). Both of these are called "pass-through" entities because there is no taxation at the corporate level. Instead, profits or losses are passed through to the shareholders and reported on their individual tax returns.

S corporations have some ownership limitations. There can only be one class of stock and there cannot be more than 100 shareholders, none of whom can be foreigners. State registered LLCs have become a popular choice for many businesses. They offer more flexible ownership than S corporations and certain tax advantages.

Whether you are already in business or just starting out, choosing the right form of business is important. Even established businesses change from one form to another during their lifetime. Some companies use more than one type of corporation - for example, an LLC to hold the business real estate and an S corporation for other operations.

The tax and legal implications of an entity selection are complex. Please contact us if you need tax consulting for your circumstances. We can also work with your attorney or refer you to an attorney to provide a team approach as needed.