Starting a Business - What to Consider

Before you start a new business, there are a number of preliminary decisions to be made. One of the first choices you will face, is the legal form in which you will operate the business. Should it be an unincorporated sole proprietorship, a partnership, a limited liability company, a regular corporation, or an S corporation? Each of these forms has both tax and non-tax advantages and disadvantages that must be weighed in conjunction with your own plans and personal situation.

Sole proprietorships, for example, are the easiest and cheapest business form to set up, and they can be operated with few formalities. However, they offer no personal liability protection and don't allow you to get many of the tax benefits that are available to corporate employees.

Partnerships offer many of the same advantages and disadvantages as the sole proprietorship, but they allow the business to be owned and run by more than one person. Also, the liability problem can be overcome to a certain extent by forming a limited partnership, but partners whose liability is limited cannot be involved in actively managing the business. And losses from these partnerships may be restricted by the so-called passive activity rules .

A newer form of entity, known as the limited liability company, which is approved for use in almost every state, offers what many see as the best alternative for the typical small business. These entities can be set up to be taxed as partnerships, avoiding the corporate income tax, while the managing members' personal assets remain fully protected from business creditors.

S corporations also offer liability protection, without a separate corporate tax. Like partners and sole proprietors, however, more-than 2% S corporation shareholders are ineligible for tax-favored fringe benefits. Another potential drawback of S corporations results from limitations on the number and kind of permissible shareholders. These restrictions can limit an S corporation's growth potential and access to capital in some businesses. In others, however, an S corporation can be a key ingredient toward success.

What about regular corporations, known as C corporations? They do not have the shareholder restrictions that apply to S corporations, but they are subject to a double system of taxation. That is, their profits are subject to income tax at the corporate level, and are also taxed to the shareholders if distributed as dividends. But if profits are to be plowed back into the business to foster the company's growth, the tax price is usually lower than with an S corporation. And there are many situations in which the double tax can be substantially minimized. An advantage to this form of operation is that shareholder-employees are entitled to tax-advantaged corporate-type fringe benefits, such as medical coverage, disability insurance, and group-term life.

Besides the question of choosing a form of entity for your new business, there are many other tax decisions to be made, and much planning to ensure that you meet your income and payroll tax reporting and compliance chores properly. How will you handle your start-up costs? Will your workers be employees or independent contractors? Can you qualify for a home office deduction? Should you set up a qualified retirement plan, and, if so, what kind?

Please do not hesitate to call to set up an appointment to explore these important matters further. With our experience, we can help you come to the right decisions and implement them quickly so that you can concentrate on the success of your new venture.