Business Formation:

We all have seen the increase in the new tax laws that benefit Small Business. We have investigated the latest tax laws that are offered. Each individual will have to take a look at several Business Forms in order to satisfy their own tax situations. Use the links on this page and take advantage of the Business Formation that will be most beneficial to your business.

Business Partnerships, vs **Sole Proprietorship,** vs **Limited Liability Corporation,** vs **Corporation,** vs **S Corporation,** take your time andstudy the**advantages and disadvantages** of each and then decide what is the best for you. You work hard to build your Business. That is why it is important to take full advantage of the Tax Laws. A plan of action is needed to fulfill the goal of being your own boss and running a successful business. Success lies in the approach you choose to take, and this section will help you with facts regarding early business formation.

The pattern is fairly well established. Once the entrepreneur has determined the goods or services the company will offer and whether there is a market for the product, a decision must be made on the type of business formation.Usually you will choose either a sole proprietorship, a partnership. , a limited liability company (LLC), or a corporation. There's no right or wrong choice that fits everyone. Your job is to understand the advantages and disadvantages of each legal structure and pick the one that best meets your needs. The best choice is not always obvious. After reviewing this section, look over advantages and disadvantages at**"Business Formation"**.

You will want to take into account the following:

- Your vision regarding the size and nature of your business.
- The level of control you wish to have.
- The level of "structure" you are willing to deal with.
- The business's vulnerability to lawsuits.
- Tax implications of the different ownership structures.
- Expected profit (or loss) of the business.
- Whether or not you need to re-invest earnings into the business.
- Your need for access to cash out of the business for yourself.

Selecting Your Business Form

Sole Proprietorship

The majority of all small business start out as Sole Proprietorship. These firms are owned by one person, usually the individual who has day-to-day responsibility for running the business. Sole proprietors own all the assets of the business and the profits generated by it. They also assume complete responsibility for any of its liabilities or debts. In the view of the law and the public, you are one in the same with the business.Currently used by more than 75 percent of all businesses, it is often the suggested way for a new business that does not carry great personal liability threats. The owner simply needs to secure the necessary licenses, tax identification numbers, and certifications in his or her name, and you are now in business.

Major advantages that differentiate the sole proprietorship from the other legal forms are (1) the ease with which it can be started, (2) the owner's freedom to make decisions, and (3) the distribution of profits (owner takes all).

Advantages

- Easiest and least expensive form of ownership to organize.
- Sole proprietors are in complete control, and within the parameters of the law, may make decisions as they see fit.
- Sole proprietors receive all income generated by the business to keep or reinvest.
- Profits from the business flow-through directly to the owner's personal tax return.
- The business is easy to dissolve, if desired.

Disadvantages

- Sole proprietors have unlimited liability and are legally responsible for all debts against the business. Their business and personal assets are at risk.
- May be at a disadvantage in raising funds and are often limited to using funds from personal savings or consumer loans.

- May have a hard time attracting high-caliber employees, or those that are motivated by the opportunity to own a part of the business.
- Some employee benefits such as owner's medical insurance premiums are not**directly** deductible from business income (only partially deductible as an adjustment to income).
- A corporation pays 15% federal income tax on taxable income up to $50,000; 25% tax on income from $50,001 - $75,000; 34% tax on income from $75,001 - $100,000; 39% tax on income from $100,001 - $335,000; and 34% tax on income over $335,000.
- A sole proprietor who filed a federal income tax return under the status of married, filing jointly, would pay 15% federal income tax on taxable income up to $35,800; 28% tax on income from $35,801 to 86,500; and 31% tax on income over $86,501.
- Sale/Transfer of All or Part of the Business. The sole proprietor can transfer the business only by the sale of business assets. This means it is more difficult to have someone buy into the business, and there are potential tax consequences of converting a sole proprietorship to a corporation or a Limited Liability Company rather than starting out with a durable form of business entity.

Federal Tax Forms for Sole Proprietorship

- Form 1040: Individual Income Tax Return
- Schedule C: Profit or Loss from Business (or Schedule C-EZ)
- Schedule SE: Self-Employment Tax
- Form 1040-ES: Estimated Tax for Individuals
- Form 4562: Depreciation and Amortization
- Form 8829: Expenses for Business Use of your Home

Types of Partnerships

Partnership

In a **Business Partnership,**, two or more people share ownership of a single business. Like sole proprietorships, the laws do not distinguish between the business and its owners. The Partners should have a legal agreement that sets forth how decisions will be made, profits will be shared, disputes will be resolved, how future partners will be admitted to the partnership, how partners can be bought out, or what steps will be taken to dissolve the partnership when needed;. Its difficult to think about a "break-up" when the business is just getting started, but many partnerships split up at crisis times and unless there is a defined process, there will be problems. They also must decide up front how much time and capital each will contribute.

Advantages of a Partnership

- Partnerships are relatively easy to establish; however time should be invested in developing the partnership agreement.
- With more than one owner, the ability to raise funds may be increased.
- The profits from the business flow directly through to the partners' personal tax returns.
- Prospective employees may be attracted to the business if given the incentive to become a partner.
- The business usually will benefit from partners who have complementary skills.

Disadvantages of a Partnership

- Partners are jointly and individually liable for the actions of the other partners.
- Profits must be shared with others.
- Since decisions are shared, disagreements can occur.
- Some employee benefits are not deductible from business income on tax returns.
- The partnership may have a limited life; it may end upon the withdrawal or death of a partner.

General Partnership

Partners divide responsibility for management and liability, as well as the shares of profit or loss according to their internal agreement. Equal shares are assumed unless there is a written agreement that states differently.

Advantages

- Simple and inexpensive to create and operate
- Owners (partners) report their share of profit or loss on their personal tax returns

Disadvantages

- Owners (partners) personally liable for business debts

Limited Partnership

Limited Partnership and Partnership with limited liability
"Limited" means that most of the partners have limited liability (to the extent of their investment) as well as limited input regarding management decisions, which generally encourages investors for short term projects, or for investing in capital assets. This form of ownership is not often used for operating retail or service businesses.

Advantages

- Limited partners have limited personal liability for business debts as long as they don't participate in management
- General partners can raise cash without involving outside investors in management of business

Disadvantages

- General partners personally liable for business debts
- More expensive to create than general partnership
- Suitable mainly for companies that invest in real estate

Federal Tax Forms for Partnerships

- Form 1065: Partnership Return of Income
- Form 1065 K-1: Partner's Share of Income, Credit, Deductions
- Form 4562: Depreciation
- Form 1040: Individual Income Tax Return
- Schedule E: Supplemental Income and Loss
- Schedule SE: Self-Employment Tax
- Form 1040-ES: Estimated Tax for Individuals

Coprorate Structures

Corporation

A corporation, chartered by the state in which it is headquartered, is considered by law to be a unique entity, separate and apart from those who own it. A corporation can be taxed; it can be sued; it can enter into contractual agreements. The owners of a corporation are its shareholders. The shareholders elect a board of directors to oversee the major policies and decisions. The corporation has a life of its own and does not dissolve when ownership changes.

Advantages

- Shareholders have limited liability for the corporation's debts or judgments against the corporations.
- Generally, shareholders can only be held accountable for their investment in stock of the company. (Note however, that officers can be held personally liable for their actions, such as the failure to withhold and pay employment taxes.)
- Corporations can raise additional funds through the sale of stock.
- A corporation may deduct the cost of benefits it provides to officers and employees.
- Can elect **S Corporation** status if certain requirements are met. This election enables company to be taxed similar to a partnership.

- A corporation pays 15% federal income tax on taxable income up to $50,000; 25% tax on income from $50,001 - $75,000; 34% tax on income from $75,001 - $100,000; 39% tax on income from $100,001 - $335,000; and 34% tax on income over $335,000.
- A sole proprietor who filed a federal income tax return under the status of married, filing jointly, would pay 15% federal income tax on taxable income up to $35,800; 28% tax on income from $35,801 to 86,500; and 31% tax on income over $86,501.

Disadvantages of a Corporation

- The process of incorporation requires more time and money than other forms of organization.
- Corporations are monitored by federal, state and some local agencies, and as a result may have more paperwork to comply with regulations.
- Incorporating may result in higher overall taxes. Dividends paid to shareholders are not deductible form business income, thus this income can be taxed twice.

Federal Tax Forms for Regular or "C" Corporations

- Form 1120 or 1120-A: Corporation Income Tax Return
- Form 1120-W Estimated Tax for Corporation
- Form 8109-B Deposit Coupon
- Form 4625 Depreciation

Subchapter S Corporation

A tax election only; this election enables the shareholder to treat the earnings and profits as distributions, and have them pass thru directly to their personal tax return. The catch here is that the shareholder, if working for the company, and if there is a profit, must pay herself wages, and it must meet standards of "reasonable compensation". This can vary by geographical region as well as occupation, but the basic rule is to pay yourself what you would have to pay someone to do your job, as long as there is enough profit. If you do not do this, the IRS can reclassify all of the earnings and profit as wages, and you will be liable for all of the payroll taxes on the total amount.

Advantages

- Owners have limited personal liability for business debts
- Owners report their share of corporate profit or loss on their personal tax returns
- Owners can use corporate loss to offset income from other sources

Disadvantages

- More expensive to create than partnership or sole proprietorship
- More paperwork than for a limited liability company, which offers similar advantages
- Income must be allocated to owners according to their ownership interests
- Fringe benefits limited for owners who own more than 2% of shares.

Federal Tax Forms for Subchapter S Corporations

- Form 1120S: Income Tax Return for S Corporation
- 1120S K-1: Shareholder's Share of Income, Credit, Deductions
- Form 4625 Depreciation
- Form 1040: Individual Income Tax Return
- Schedule E: Supplemental Income and Loss
- Schedule SE: Self-Employment Tax
- Form 1040-ES: Estimated Tax for Individuals