

The Law Office of

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**Sole proprietorship, LLC, or
Corporation**

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Business Form Considerations

- Liability
- Ownership and management
- Filing requirements and fees
- Record-keeping formalities
- Taxes



Types of Business Entities

- Sole proprietorship
- Partnerships
 - General partnership
 - Limited partnership
- Corporations
 - C-Corps
 - S-Corps
- Limited Liability Company (LLC)



Sole proprietorship

- Business is owned by one person (or by a husband/wife or domestic partners)
- No formal requirements to form or conduct business
- Not a separate legal entity from its owner; business profits/losses reported on your personal tax return (“pass-through” taxation)
- Unlimited personal liability for business debts



General partnership

- A business conducted by 2 or more people
- Each partner has unlimited personal liability for the debts and obligations of the business
- The business actions of any one partner bind the other partners
- Each partner pays tax on his or her share of the partnership income
- Flexible in sharing profits and losses
- No formal state requirements or filing to form



Liability and Limiting It

- Sole prop has no limits, but LLC and corporations limit liability
- Creditors of LLC/corp cannot normally go after the owners' personal assets to pay for business debts or claims arising from lawsuits
- In other words, your personal liability is limited to the amount you invested



Liability Cont.

- It's a protection, but not invincibility. Kind of like a seat belt. There are exceptions for:
 - Alter ego liability: no financial-administrative separation of owner/entity
 - Fraud
 - Inadequate funding considering type of operations
- Statistically, single-owner LLC/corps are more vulnerable to alter ego. Keep records!



Corporation

- Separate legal entity
- Corporate formalities – minutes, annual meetings, shareholder or director approvals or significant actions, state filings
- Owned by shareholders (can be just one)
- Managed by directors (can be just one)
- Run by officers (one person can hold multiple positions)
- Liability is limited to the corporation's assets, not the individual owner's

Corporation – filings & formalities

- File with CA Secretary of State:
 - Articles of incorporation: \$100 filing fee
 - Annual “Statement of Information”: \$25 filing fee
- Open separate bank account
- Hold meetings and take minutes
- Maintain corporate records books
- File annual tax returns with IRS and FTB



Corporations – tax treatment

- Corporation is a “C-Corp” unless it files “S-Corp” election with the IRS.
- C-Corps have two levels of tax:
 - Corporation pays tax on net income
 - Shareholders pay tax on dividends (shareholder’s share of corporation’s profits)
- No federal income tax on an S-Corp; CA imposes a tax (greater of \$800, or 1.5% of net income)
- Profit/loss from S-Corp “passes through” to shareholder’s personal tax return
- Most small businesses choose be S-corps

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Qualifying as an S-Corp

- File “S election” with the IRS
- No more than 100 shareholders
- Shareholders must be individuals, qualified trusts, or charities
- Shareholders must be U.S. citizens or legal residents
- Only one class of stock: must have identical economic rights, but may have different voting rights



Corporations With Extra Values

- At the beginning of 2012, California introduced legislation allowing two new corporate forms:
 - B Corporation (high compliance standard)
 - Flexible Purpose Corporation (easier)
- These new forms allow for corporations to have other goals other than maximizing shareholder value



Limited Liability Company (LLC)

- Name must include “LLC”
- May not engage in banking, insurance, trust company business, or “professional services”
- Owners of the LLC are called “members”
- LLC may have one or multiple members, who may be individuals or entities
- Can be member-managed or manager-managed
- Fewer formalities and more flexible than a corporation
- Members can manage the LLC, or appoint a “manager”
- Liability limited to the LLC’s assets



LLC (cont'd)

- A one-member LLC is “disregarded” for federal tax purposes, and treated as a sole proprietorship
- LLC with two or more members is treated as a partnership for tax purposes, and each member pays his share of the LLC’s income
- LLC member(s) can elect to have LLC treated as a corporation or S-corporation
- Maximum flexibility in sharing profits and losses



LLC – filings & formalities

- File Articles of Organization with the Secretary of State
 - \$70 filing fee
- Pay \$800 annual tax due to FTB – first year payable within 3 months and 15 days of formation
 - Also subject to annual fee to FTB based on LLC's gross income (up to \$12,590, if gross income exceeds \$5 million)
- Written Operating Agreement is highly recommended (no need to file with State)
 - If not in writing, CA's default rules may govern
- File annual Statement of Information with Secretary of State : \$20 filing fee every other year
- File annual tax return with IRS



So...S-Corp or LLC?

	S-Corp	LLC
Liability	Limited	Limited
Ownership	Limited to individuals, certain trusts, charities; no more than 100 shareholders	Unlimited
Management	Board and Officers	Flexible – Members or Managers
Annual State Taxes	1.5% of net income Minimum: \$800 Maximum: N/A	Based on gross income Minimum: \$800 Maximum: \$12,590
Allocation of profits and losses	Must allocate profits according to the percentage of stock each owner has	May distribute profits however you see fit

Who *typically* chooses what form?

These are gross generalizations so consult with an attorney and tax adviser before acting on them, but usually:

- Sole prop: Simple, low-hazard businesses
- LLC: More hazard or more people, but low overhead
- S-corp: Higher-overhead biz, for tax based on net income not gross receipts
- C-corp: Outside investors, stock option pool, and/or shareholders that are not (or someday might not be) residents



Questions?

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