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The Law Firm For Entrepreneurs, Business Owners & Investors

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Do You Want to Start A Business?

Top 10 Questions & Answers For Business Start-Ups

When starting a new business, our clients often have several questions and more often than not their questions are the same. This article summarizes some of key questions and answers that our clients have asked us.

1. What Are the Different Forms of Business Entities That I Can Select from?

There are many different types of business entities that one can select and the decision is governed by tax considerations, risk tolerance, budget and personal goals. For the most part, your decision will be between a Sole Proprietorship (“SP”), Corporation (“C”) a Limited Liability Company (“LLC”) or a form of Partnership (“P”) and each entity has various advantages and disadvantages. A Sole Proprietorship is the easiest entity to set up but does not protect the owner’s personal property if someone decides to sue the business. Instead, the company and the individual are considered the same person and if the business is sued or incurs debts, you, the business owner, will be personally liable. A Corporation and LLC, while more complicated to set up, solves the problem of personally being sued by separating the individual and the business. These entities are both “limited liability” entities where your risk is typically limited to the amount of money you invest in the business. A Partnership can also be set up as a limited liability entity and often accounting, consulting and law firms are set up using this business form.

2. Should I Select An Entity With Limited Liability Protection?

Generally Yes. Even though a Sole Proprietorship is easy to set up, in order to better separate personal & business finances, a business entity that offers limited liability protection is highly recommended. This can be a Corporation, a Limited Liability Company or a Limited Partnership and these entities will stop a creditor or litigant from coming after your home or personal assets. For those who think there is very little risk of being sued, your risk jumps significantly if you deal with vendors, hire employees or have clients visit your premises. Even a picture on your website can result in a law suit. As a practical tip, to ensure that your personal assets are truly protected, you should remember to always try to ONLY include the name of the business on any legal documents such as a loan document, lease, utilities set up, etc.. If you also include your name you may inadvertently extend the liability of your entity to yourself.

In addition to the limited liability protection there are several good reasons why you should select a business entity other than a Sole Proprietorship.

- A separate business entity adds legitimacy and credibility to your business.
- You will have more flexibility when it comes to tax planning. (this is a complicated area and you should consult with your lawyer or tax advisor).
- You will start to develop business credit. You will find that when you start your business, most creditors/others will require that you sign personally along with the business. (For example, if you sign a lease the owner of the property will have your name and the company's name on the lease). Just like an individual establishes credit a business can establish credit and this can best be done if the business is a separate entity.

3. Should I Select a LLC or Corporation?

The determination of which business entity to select requires a comprehensive assessment of the particular facts and circumstances of your company and should be done in conjunction with a lawyer and/or accountant. We have included a summary of the advantages and disadvantages of these two entities below.

	Corporation	Limited Liability Company
Advantages	<p>Limited liability - Corporation is a separate legal entity & if someone sues and wins, they cannot come after your personal assets. (eg. your home)</p> <p>Capital is easy to raise through sale of stock.</p> <p>Tax savings through income splitting (C only).</p> <p>Double taxation can be avoided if you set up an S-Corporation but this requires an extra step of applying for S-Corp Status.</p> <p>Potential savings in payroll self employment taxes.</p>	<p>Limited liability – LLC is a separate legal entity & if someone sues and wins, they cannot come after your personal assets.</p> <p>Capital is easy to raise through sale of interests.</p> <p>Avoids double taxation as an LLC is a pass through entity so that the income flows through to your personal income tax return.</p> <p>Tax preparation simpler as you do not have to prepare a corporate tax return.</p> <p>Easy to set up – Just create an operating agreement and meet publication requirement. Very little administrative formalities to follow.</p>
Disadvantages	<p>More administrative compliance required as you must appoint a board, develop articles of incorporation, create bylaws and follow other formalities.</p> <p>A separate corporate tax return is required and this can be expensive to prepare.</p> <p>S Corp must have fewer than 100</p>	<p>Can be costly to form due to publication requirement.</p> <p>You may pay more in employment taxes.</p>

	Corporation	Limited Liability Company
	shareholders and owners must be resident aliens. S Corp status may not be recognized by local branches of government. (eg. not recognized in New York City)	

4. What is an S Corp?

When you search the Internet, you will see many references to an “entity” referred to as a S-Corporations but it is best to think of “S” as a TAX STATUS rather than as a type of entity. If you do, most of your confusion will vanish. So here is the lowdown.

S status is a tax categorization that allows an entity to avoid the problem of double taxation by allowing income to flow through to the business owner’s personal tax return. This is particularly important for a Corporation as without S status, a business owner would be forced to pay taxes on corporate earnings as well as personal distributions (this is why it is called double taxation). S status also has the potential advantage of saving the business owner some amount of payroll taxes. You should keep in mind that BOTH a Corporation and a LLC may elect S status and if they do, they could avoid self-employment taxes on at least a portion of their earnings. Here is a brief and simple example. An entity (LLC or Corporation) makes \$100,000 and the owner assigns themselves a salary of \$60,000 (salary must be reasonable in order to qualify). When this occurs, and S status is elected, the owner will only have to pay self-employment tax on the \$60,000 rather than the full \$100,000. Do not confuse self-employment tax with income tax as income tax is paid on the full \$100,000 and this cannot be avoided. In order to be eligible, you must file the S tax status election with the IRS right after you set up the LLC or Corporation (they give you around 60 days). If you forget to make your S election, the IRS will usually accept late applications provided you have a good reason. (eg. bad advice from your accountant)

S status though, does have drawbacks as the ownership structure is not that flexible and you must be a U.S. resident for tax purposes to be eligible. In addition, if you elect S Status there is a limitation on the amount of owners that may hold shares or membership units in the company. If you are considering electing S Status, you should consult a Lawyer or Accountant as it is a complicated area.

5. What is an LLC?

An LLC (Limited Liability Company) is a hybrid of a sole proprietorship/partnership and corporation. This structure is very popular among small businesses, and for good reason. The LLC limits the personal liability of the owners, but doesn’t require much of the heavy formality and paperwork of the corporation. This makes it a great choice for business owners that want liability protection but don’t want to deal with

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meetings, documenting minutes, addendum filings or other paperwork you would need to file as a corporation. If you want to avoid corporate formalities, a LLC might be perfect for you. As described in the disadvantages above, the publication requirement is an initial outlay that discourages many from this entity.

Click here for some additional tax considerations that further explain the advantages of an LLC.

6. Where Should I incorporate?

I am often asked the question of whether an entity should incorporate in Delaware, Wyoming or Nevada and this is because Delaware offers flexible, pro-business laws, and Wyoming and Nevada have low filing fees and no state income taxes.

As a general rule of thumb, if your business has a small number of shareholders, you should incorporate in the state where you actually live or where your business has a an office. This is primarily because incorporating in a different state from where you are doing business will require you to have to deal with added fees, filings and paperwork and you still may have to file forms in your home State. In our opinion, for most small businesses the added hassle and fees are not worth it. This decision should be made with a qualified lawyer so that the companies goals can be explored.

7. Can I Hire Someone and Pay Them As An Independent contractor?

The question of whether or not someone is an employee or independent contractor often comes up and many small businesses make the mistake of incorrectly classifying workers as independent contractors (and issuing a 1099) rather than properly classifying these individuals as employees. One obvious advantage of the independent contractor classification is avoiding payroll taxes but the correct classification is one that is based on substance rather than form. To make this determination the Internal Revenue Service lists a number of factors that must be considered and generally speaking when a small business hires a worker to perform day-to-day tasks, the worker will be an employee. You should keep in mind that an incorrect classification could lead to significant penalties and it is not difficult for the government to “catch” those who classify incorrectly. As a result, when hiring staff, you are advised to seek out counsel from a qualified employment attorney. We refer all of our employment matters to White & Harris, a law firm that specializes exclusively in employer based employment law.

8. If I Am A Foreign National Do I Need A Visa To Run A Business In The U.S.?

Yes. In order to be present in the U.S. and operate a business, you must have a Visa. Generally speaking there are 4 Visa types that a small business can consider. These are the E-2 Investor Visa, H-1B Visa, L Visa & EB-5 Visa. To find out more about each of these visas click here.

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9. If I Issue Stock To My Friends & Family Do I Have To Comply With SEC Regulations?

Yes. Many small business want to raise funds to finance ongoing operations and you are required to comply with the Securities Exchange Commission's (SEC) requirements if you sell stock or any security. The term "security" is defined by Statute but most financial products that a company can sell to an investor would qualify as a security. (For example, preferred stock, convertible debt, member units, common stock, etc.) In addition to federal SEC requirements, a company that issues securities would also have to comply with State Securities regulations.

All of the government requirements have been set up to protect investors and generally require any company who wants to attract investors to provide the investors with information such as financial statements, offering documents, prospectuses and other information so that an investor can make an informed decision. Failure to follow these requirements can result in dire consequences.

10. Should I Hire A Lawyer If I Start A Business?

Yes. Starting a business can be complicated and finding a qualified lawyer to assist you with your business entity selection, issuance of stock, obtaining the proper Visa and strategy advice is essential. In addition, a lawyer can get you to start thinking about the right questions to ask and can put a legal framework around your business that could save you money.

If you are considering issuing securities to friends and family, contact Scott Legal Services, P.C. for a consultation. You can call us at 212-223-2964 or email us at iscott@legalservicesincorporated.com.