Guide to:

Forming An LLC

Congratulations! You have decided to start your own business.

That is a courageous step and one that can lead to rewards that no job can offer. When you are working for yourself, you have the opportunity to reap directly the rewards for your efforts while exercising greater control over how you spend your time. In addition, you will make the decisions that impact your future.

One of the first decisions you will make in running your new business is what legal form your business should take. If you have not thought about this yet, you should. If you do nothing, you will default into being a sole proprietorship. While you will not be alone in that regard, you may be missing out on many of the benefits afforded by creating a separate business entity and exposing yourself to liabilities by failing to do so. Many people avoid taking steps to create a distinct legal entity for their business because they believe it will be costly to do so. Not taking those steps, however, may be the costliest decision of all in the long run. Even in the short run, using an experienced document filing service, such as CorpNet, can keep initial costs to a minimum. Using an online filing service such as CorpNet.com is a great way to get started in setting up your entity, you can save both time and money because we are fast, reliable and affordable, and our services are backed by a 100% satisfaction guarantee.

Limited Liability Company

Introduction

A Limited Liability Company is a legal entity that bears similarities to both corporations and partnerships. An LLC is not a corporation; it is formed under specific state statutes that provide for the creation and regulation of this special type of business structure that has come to be commonly used and respected in business. An LLC can be used to combine the limited liability features of a corporation with the flexibility and tax benefits of a partnership.

Owners of an LLC are generally known as “members.” Management and control of the entity resides with the members unless otherwise provided in the formation documents.

While an LLC does require the filing of Articles of Organization and the adoption of an Operating Agreement by its members, our document filing service can provide you with the assistance you need to meet these requirements with minimal investment of your valuable time and money. Using CorpNet™ can save you both time and money with service that is fast, reliable and affordable. And remember, our services are backed by a 100% satisfaction guarantee. We make everything easy for you so that you can focus on what you do best – running your business!

Benefits of an LLC

Limited Liability

Like a corporation, owners of an LLC enjoy limited liability, which protects their personal assets from judgments and other obligations of the entity. If the LLC incurs debts or liabilities, the creditors are limited to the assets of the LLC. In the event the assets are insufficient to cover the debts of the business, creditors may not generally collect additional amounts from the members. By contrast, a Sole Proprietor is personally liable for all the obligations of the business. This means that Sole Proprietors risk everything they own to satisfy the debts or judgments of their respective businesses, including their homes, cars and personal savings and investments.

Fewer Formalities Required

An LLC also typically requires fewer corporate formalities, such as regular meetings of a board of directors and an annual meeting of shareholders, than either an S or C corporation. LLCs do, however, require filing of Articles of Organization to be properly formed, and the members of the LLC must enter into an Operating Agreement that governs how the LLC will be operated.

Pass-Through Tax Treatment

LLCs are treated as “pass through” entities under the Internal Revenue Code unless the members elect to have it taxed like a corporation. This means that the owners report profits and losses only on their own personal income tax forms and no separate entity level filing is required. If a C-Corporation earns a profit, that profit is taxed. If those profits are then distributed to its shareholders, the shareholders pay income taxes on those dividends. This is known as the “double tax” and, while there are ways for small businesses to legitimately avoid the double tax, LLCs that have pass-through tax treatment are not subject to it at all.

Flexible Allocation of Profits and Losses

Members of an LLC may generally agree to allocate profits and losses among themselves by agreement; they are not required to allocate them in proportion to ownership interest. This allows for more flexibility in separating ownership interest from distribution of profits from ongoing operations, which may be useful, for example, in businesses where some owners are actively involved in day-to-day activities while others are not. It also provides significant flexibility in tax planning for its members.

Member-Managed and Manager-Managed LLCs

An LLC offers significant flexibility in how its day-to-day operations are managed. LLCs may be managed by its members (a Member-Managed LLC) or by managers (Manager-Managed LLCs). In single-member LLCs, the member usually manages the operations directly. If there is more than one member, the members may divide the management responsibility among themselves, or they may elect one or more managers. A manager need not be a member of the LLC to serve in that capacity. For businesses where the members are actively involved in running the business, the members generally serve as the managers of the LLC.

Tax Treatment

LLCs are generally treated as pass-through entities for income tax purposes as described above. LLCs with a single member are treated just like a Sole Proprietorship – the owner reports profits or losses on Schedule C of his or her personal tax return. No entity-level tax return is required to be filed. For multiple member LLCs, the default tax treatment is that of a partnership. Although the LLC is not subject to income taxes, an income tax statement is prepared and filed on behalf of the LLC allocating profits and losses among the members. The members, in turn, include such amounts on their personal income tax returns. There may be instances where it is tax advantageous for the LLC to be taxed as a corporation and the LLC owner may choose such tax treatment by making a filing with the Internal Revenue Service (IRS). An owner of an LLC with pass-through taxation pays personal income tax on all the profits of the LLC even if some of the profits are left invested in the business. With corporate taxation, income tax is only paid at the personal level if there is a distribution of profits to the shareholders. Depending on the particular facts and circumstances of the business, being taxed as a corporation may be better or worse than staying with the default of pass-through taxation. The advantage to the LLC is that either tax treatment method can be chosen, and the decision

LLC vs. C Corporation

A limited liability company (LLC) is often chosen by small business owners because of the flexible tax treatment discussed above. An LLC generally does not pay tax at the entity level and thus an LLC owner only pays tax on the profits of the LLC on his or her individual income tax return. For those LLC owners who wish to be taxed as a corporation, however, they may elect such tax treatment by making a filing with the IRS.

Another advantage of an LLC over a corporation is the ability to allocate profits and losses among the members as the members agree, while in Corporations dividends are generally paid pro rata according to share ownership. The IRS allows for special allocations for LLCs, and we recommend consulting your accountant or tax advisor to learn more about this option.

Finally, an LLC generally requires fewer corporate formalities than a corporation. LLC’s may be managed directly by members; there is no need to have a separate board of directors or annual shareholder meetings and periodic directors’ meetings with minutes. For many, the convenience and simplicity of forming a single-member LLC that is managed by the member provides limited liability protection without adding a lot of corporate bureaucracy.

LLC vs. S Corporation

An S Corporation combines pass-through tax treatment with limited liability protection like an LLC but does have several limitations that business owners should be aware of when choosing between the two. A big difference is that LLCs do not have the same restrictions on ownership as S corporations. S corporations must be owned by individuals (or trusts) that are U.S. citizens or residents, and there must not be more than 100 shareholders. LLCs may be owned by other LLCs or corporations and the owners do not have to be U.S. citizens or residents. There may be an unlimited number of owners in an LLC.

An S corporation does not allow for the flexible distribution of profits and losses like an LLC. In an S Corporation, dividends are paid to shareholders in proportion to share ownership. LLCs may follow the IRS's special allocation rules to agree to allocations of profits and losses that vary from ownership interests.

The advantage that LLCs have over corporations in the area of corporate formalities also applies to S corporations. In fact, in forming an S corporation, small business owners not only have to make the filings and comply with the ongoing requirements for maintaining a corporation, but they also have to make an additional filing with the IRS to elect S corporation status and receive pass-through tax treatment. For LLCs, pass-through tax treatment follows automatically upon filing the Articles of Organization.

Comparing Business Structures

The following chart provides a high-level comparison of the most popular business forms across important attributes to consider when forming your business:

	Sole Proprietor	General Partnership	C-Corp	S-Corp	LLC
Formation	No Filing Required	No Filing Required	State Filing Required	State Filing Required	State Filing Required
Limited Personal Liability	NO	NO	YES	YES	YES
Transferability of Interest	NO	NO	YES	Generally Limited	YES, Often Limited
Duration	Until withdrawal or death of owner	Unlimited	Unlimited	Unlimited	Unlimited
Pass-Through Taxation	YES	YES	NO	YES	YES, Unless election made otherwise
Ability to Raise Capital	Not as a separate entity	YES	YES	Yes, but shareholder limits	YES
Limits on number of owners	YES	NO	NO	YES	NO

What about LPs, FLPs, PLLCs and LLPs?

LPs are limited partnerships

They provide limited liability protection for passive investors in the business (the limited partners), but not for the general partner (who is responsible for managing the day-to-day operations of the partnership).

FLPs are family limited partnerships

They are similar to limited partnerships but are formed by family members and can provide benefits in the form of tax planning and providing for an orderly transfer of control from older family members to younger ones. If you have a family business and are interested in this type of entity, consult your tax and legal advisors to see if it is right for you. we can help you form an FLP if you choose this structure.

PLLCs are Professional Limited Liability Companies

They are limited liability companies that are formed for the purpose of providing professional services. Most states require professional service providers (that is, for professions that require a license to provide services such as doctors, lawyers, architects, engineers, etc.) form a PLLC rather than an LLC. California, however, does not allow a PLLC to be formed at all. State laws vary in this area so the law in your specific state should be carefully reviewed before proceeding. Once you know what kind of entity you need, we can help you take the next steps to create it.

Most states allow for LLPs, which are Limited Liability Partnerships. LLPs combine limited liability protection with partnership tax treatment. LLPs are a type of general partnership that typically provide the general partner of the partnership with limited liability
from the obligations and liabilities of the partnership. The limited liability partnership entity is a relatively new business form. If you decide to form an LLP, you will need to file an application or registration in the jurisdiction of your choice.

Where to File?

Once you decide to form an LLC, you need to choose a state in which to make your filing. Most people choose Delaware, Nevada, or their home state. Delaware is often chosen, especially by larger companies, because it has the most developed and flexible corporate statutes in the country and is considered pro-business. Nevada has also become popular because of its lack of state corporate income tax, franchise tax and personal income tax. It also has relatively low fees.

Nevertheless, if you have a small business and are going to be conducting a substantial amount of your business in your home state, it will likely be beneficial to form your LLC in that state. If you form your LLC out-of-state but do much of your business in your home state, you will have to make a filing to “qualify to do business” in the state if there is a substantial ongoing business or physical presence in the state. You will then be subject to the same fees, taxes, and regulations as if you had formed your LLC there in the first place, and you will have paid filing fees (and, perhaps franchise taxes) to more than one state.

Keeping an LLC in Compliance

Keeping your LLC in compliance with legal and tax requirements at the federal, state, and local levels is important to ensure that you receive the full benefits of forming an LLC, including limited liability. Keeping your personal assets protected is one of the most important benefits of an LLC and making sure you comply with the various regulations applicable to your entity and business will make it harder for creditors to “pierce the corporate veil” and hold you personally liable for the debts and obligations of the business. Of course, the first step is making sure your Articles of Organization are properly filed and that you have created an Operating Agreement.

LLCs, like all businesses, are subject to a variety of taxes and regulations. Most states have an annual franchise fee for the LLC and/or an annual report fee and filing requirement. If the LLC has employees, it will need to apply for a separate tax identification number from the IRS and make proper arrangements for payroll taxes. Depending on the type of business, special permits or business licenses may be required. CorpNet™ provides services in many of these areas. It is also recommended that you seek advice from your legal, accounting and tax advisers at the outset so you can make sure you haven’t missed anything.

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