Corporate, Partnership, and Business Law

Whether you are looking to start a new business, or need to manage and maintain an existing company, it is important to consult an attorney to ensure you are operating under the most beneficial legal arrangement. There are many different aspects to consider when building or refining a business plan. What type of legal entity will be used? Who will have control and ultimate decision-making power in your business? Will you have partners? Will you have employees or independent contractors? Will your company's physical location and business activities allow you to obtain the necessary licenses and permits to operate? What types of tax benefits are available? How will the company dissolve or proceed if there are disputes between owners? Creating a vibrant and successful business often takes years of editing and refining your business plan to be more efficient and profitable. A competent attorney can also assist with expansion actions to grow your business, such as purchasing your own commercial building or merging with another company.

Choosing a Legal Entity: Limited Liability Companies

Selecting a legal entity should take into account your personal circumstances and business goals. For example, many smaller businesses are best operated as limited liability companies, or LLC's. An LLC will limit the personal liability of its owners by absorbing any debts connected to the business operations of the LLC. For example, if a customer were to file a lawsuit against your LLC due to an accident or loss that occurred in connection with your business, the damages ultimately awarded to the customer would be limited to the assets of the LLC itself. The customer would not be able to access your personal assets in satisfying the claim against your business, such as your home or retirement savings accounts. Operating as an LLC is therefore an important tool in protecting your personal residence and retirement accounts from business creditors. In a worst case scenario, the business creditors could only force you to liquidate and close the LLC in repayment of the creditors' claims—but they would not be able to foreclose on your personal home or deplete your retirement savings accounts. Corporations provide the same type of personal liability protection as LLCs, and are discussed below.

Partnerships

Partnerships are generally undesirable legal entities for new entrepreneurs since they do not provide much liability protection for their owners by default. Partnerships require two or more partners who are usually personally liable for all of the debts of the business. This means that there may not be protection for a partner's personal assets when being sued by business creditors. Partners are usually jointly and severally liable for the business debts too, meaning that creditors can freely pursue any and all of the partners to satisfy claims. Certain specialized partnerships, such as Limited Liability Partnerships ("LLP's"), can provide some of the same liability protections of LLCs and corporations, but there are some unique rules and requirements that must be met to create a valid LLP. It is important to consult an attorney if you are contemplating using a partnership for your business arrangement. An attorney can help draft partnership agreements that modify and alter some of the disadvantageous default rules discussed here, as well as assist with properly forming a specialized limited liability partnership.

Corporation vs. LLC

When starting or reforming a business, most owners boil their decision down to choosing between an LLC or a corporation for their legal entity. Both LLCs and corporations provide personal liability protection for their owners, which is a major advantage over the default rules for partnerships. The owners of corporations are referred to as "shareholders." In contrast, LLCs are owned by "members."

One of the main differences between corporations and LLCs is the way in which they are taxed. By default, corporations are generally taxed twice, meaning they pay tax on the profits of the corporation itself, and then shareholders also pay a second wave of personal taxes on dividends disbursed to the shareholders individually. A sole-member LLC only pays one tax because LLC profits pass through to the personal income of the LLC's owner—like the second wave of taxes that shareholders pay in corporations. LLCs with two or more members are often taxed as partnerships by the IRS (Internal Revenue Service).

However, smaller LLCs can make an election to avoid the default rules and be taxed as a corporation instead. This flexibility makes LLCs an attractive option for small or new businesses. The election allows the LLC to designate itself as a "C-Corp" or "S-Corp." Generally, by designating an LLC to be taxed as a corporation, the LLC's members will be able to separate and control how much income is reported on their personal tax returns from the profits of the LLC—although this means the money will now be taxed twice if they take personal disbursements like shareholders. Since the LLC is viewed as a corporation after making the election from a tax perspective, the members can retain and reapply some of the profits within the business, and take advantage of the special tax benefits entitled to corporations. Corporate tax rates on the first wave of taxes might be lower than a person's individual income tax rate.

For example, if a business owner's personal income will be taxed at the 24% income bracket, it might make sense to leave some of the company's profits within the business instead of taking the money out for personal use to be taxed twice. The money left within the LLC-corporation will only pay the first wave of taxes under the lower corporate tax rate of 21% as of 2020. This money can be used to pay off business debts, purchase company cars and cell phones, or invest in expanding the business, etc. The LLC's members can therefore control how much of the money will be taxed twice if they take out profits for their personal use, and reinvest the business funds that have only been taxed once to save money. From a practical standpoint, many business owners would rather pay the tax only once and simply use LLC-corporate funds to pay for the owners' company cell phones and vehicles, office expenses, advertisements, etc. For owners whose lifestyles are bound to their business activities, operating as either a traditional corporation, or as an LLC making the corporate tax election, might save the most money in the long-run.

It is important to consult a business attorney and your tax preparer or accountant when making decisions based on business tax benefits. Corporations have much more complex tax and accounting work associated with them than LLCs. Your attorney can recommend and explain which business structure will ultimately make you the most money.