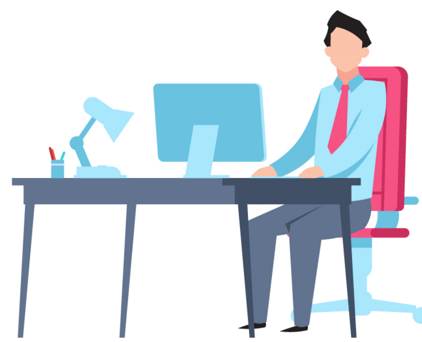
NEW LLC GUIDE

Inside this issue:

WHAT IS AN LLC?

- An LLC, Limited Liability Company, is a **legal entity** separate from its owners, and organized under the business law statutes of each state.
- All states have LLC legislation and the rules vary from state to state.
- The LLC is created by filing *Articles of Organization* at the state level.
- As a separate entity, the LLC has the power to conduct business in its own name. It can sign contracts, buy property, be sued, etc.
- An LLC can have a single owner (member) or a number of members. There is no limitation to the number.
- Similar to a Corporation, the LLC offers limited liability to its members, which includes personal asset protection.
- The LLC offers *business asset protection* from the personal debts of the members. Creditors cannot seize LLC property or force a member to liquidate due to personal debts.



- The LLC form of organization offers contractual flexibility in that the members can alter the operating agreements to suit their needs.
- Most state rulings on LLCs are relatively informal. The lack of formal rulings make decision making easier.
- The LLC form of organization is very flexible from a taxation standpoint because it allows various options for filing and paying taxes.

LLC TAX OPTIONS:

An LLC can be taxed as any one of the following entities:

- Sole Proprietorship
- Partnership
- C Corporation
- S Corporation

To elect one of the above Federal tax classifications, the LLC files Form 8832 to make its choice. If the LLC does not file Form 8832 to choose a classification,

A single-member LLC defaults to a Sole-Proprietorship.

A multi-member LLC defaults to a Partnership.

SHOULD YOU ORGANIZE YOUR BUSINESS AS AN LLC?

The answer is most likely **YES.** Nowhere else will you get limited liability teamed up with limited regulations and ease of operation.

The corporate form was set up for large business, and along with limited liability, comes the disadvantage of rules and complicated structure.

The Sole-Proprietorship, on the other hand, is easy to operate, but liability to the owner is unlimited.

THE LLC OFFERS THE BEST OF BOTH WORLDS.

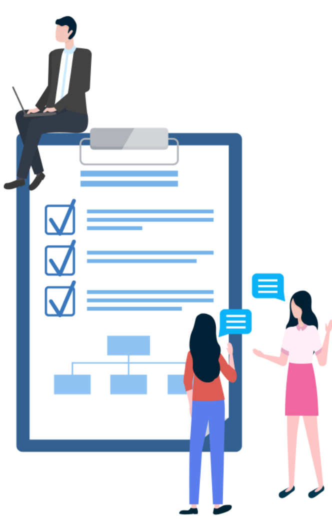
GETTING STARTED CHECKLIST

Because the LLC is a legal entity organized on the state level, you should first research the rules regarding LLCs in your state.

The website www.findlaw.com is an excellent source of state legal information.

You can use the following checklist to get started. Because the LLC is a legal entity, the help of an attorney is advised, but you can do it yourself as long as you do your research.

- Decide on a business name for your entity. Most states require some variation of LLC to be included in the name. Check with your state for details.
- According to the laws of your state, file the *Articles of Organization* for your LLC.
- Decide which tax entity best suits your business for Federal tax purposes and file Form 8832 to *check the box*. You must stay with your initial choice for 60 months, so, choose wisely.
- Outline your rules of operation with an *Operating Agreement.* The *Operating Agreement* is generally not required for the LLC to be valid, bit it's wise to map out your intentions. Items to include are:
  - Name and address for LLC and each member
  - Registered agent
  - Management structure and operation
  - Items contributed by each member
  - Accounting method
  - Tax treatment for the LLC
  - Operating procedures
  - Appointment of officers
- Arrange a schedule for regular meetings. Not all states require meetings, but meetings help the business stay on course.
- Open a bank account. Your LLC is a separate entity, and it needs its own bank account. It needs to be separate from your personal finances.



New for 2024: Report Beneficial Ownership Information (BOI) with the Financial Crimes Enforcement Network (FinCEN). You have 90 days after forming the LLC to file the report (30 days if formed after 12/31/24). LLCs that existed before 2024 have until 12/31/24 to file. Failure to comply may result in hefty fines and criminal prosecution. The details of reporting BOI are beyond the scope of this guide. For more information, go to: www.fincen.gov/boi

WHICH FEDERAL ENTITY BEST SUITS YOUR LLC?

Single owner LLC:
You have 3 choices ranging from simple to complex.

Sole Proprietor (the default)

- For Federal tax purposes, this is a *disregarded entity,* and no separate ID is required. However, if wages are paid, a Federal ID is needed for employment tax purposes.
- Combines ease of operation with limited liability.
- No complicated, separate tax return required – just Schedule C with Form 1040.
- The LLC owns and protects the assets of the Sole-Proprietorship.
- Sole Proprietors have greater "pass through" income because they do not have to pay themselves a wage like S-corporation owners do. As such, they might qualify for a larger Qualified Business Income (QBI) deduction.
- On the downside, the Sole-Proprietorship is subject to Self-employment tax on net business profit. As income increases, this can become costly.

S Corporation

- In addition to checking the box on Form 8832, you need to file Form 2553 to elect status as an S Corporation.
- This form of organization is much more rule oriented than the Sole-Proprietor.
- The members of the LLC operated as a Corporation are employees and are paid wages. By rule, the wages need to be a fair amount for the work done.
- The S Corporation files a separate tax form, 1120S, and passes its profits through to the individual level for taxation. These profits are not subject to Social Security. Thus, high income S Corporations will be able to avoid Social Security on profits in excess of wages. *Note: the IRS is currently investigating this SE tax avoidance with a series of audits. It's very important to pay a reasonable wage.*
- The LLC filing as an S Corporation would have *business asset protection* from personal debts of the members. An S Corporation that is not an LLC would not.

C Corporation

- You need to check the box on Form 8832 to elect taxation as a C Corporation.
- This business setup is designed for big business and is structured in a complicated way that requires the owner to follow many rules.
- The members of the LLC are employees and get a W-2.
- The LLC files Form 1120 and pays tax on the corporate level on the profits. When the members take the profits from the Corporation, they are taxed again as dividends. This form of business is not for everyone. Careful planning is essential.
- The LLC filing as a C Corporation would have *business asset protection* from the debts of its members. A C Corporation that is not an LLC would not. Note: Be careful not to include appreciable property in a Corporation or it will be double taxed when it is sold.
- Members who desire a benefit package might want this form of organization because the benefits can be deducted by the company, reducing Corporate tax.

Multiple owner LLC:
You have 3 choices ranging from simple to complex.

Partnership (the default)

- The simplicity of the partnership organization is combined with the limited liability of the LLC.
- A member may be classified as either a *General Partner* or a *Limited Partner.*
- Members who have contract authority and engage in LLC business are *General Partners* and will pay self-employment tax on their earnings.
- Limited Partners who are passive investors, lack contract authority, and work less than 500 hours a year are not subject to SE tax on their earnings.
- The LLC files a separate Partnership tax return on Form 1065 in which the income flows through to the partners and is taxed at the individual level.
- The LLC owns and protects the assets of the Partnership, and when these assets are distributed, the appreciation will not be taxed. For this reason, LLCs organized as partnerships are good vehicles to hold real estate.
- On the downside: As income grows, so does self-employment tax for the General Partner.

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- This form of organization is much more rule oriented than the Partnership.
- The members of the LLC operated as a Corporation are employees and are paid wages. By rule, the wages need to be a fair amount for the work done. Distributions to the members, other than wages, need to be paid in the same proportion as the ownership percentage.
- The S Corporation files a separate tax form, 1120S, and passes its profits through to the individual level for taxation. These profits are not subject to Social Security. Thus, high income S Corporations will be able to avoid Social Security on profits in excess of wages. *Note: the IRS is currently investigating this SE tax avoidance with a series of audits. It's very important to pay a reasonable wage.*
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- Members who desire a large benefit package for employees might choose this form of organization because the benefits can be deducted by the company, thus reducing Corporate tax.

STATE FILINGS

Check your state to see what forms need to be filed. Some states require separate tax returns and annual reports. To ensure the protection of your LLC, make sure you follow all of the rules. Remember: The word *limited* in the title of this type of entity means exactly that. No business organization is 100% exempt from the actions of its owners.