HOW TO DECIDE

WHICH BUSINESS STRUCTURE IS RIGHT FOR YOUR BUSINESS?

Learn which business structure will have the best impact on your business and will save you the most money for the long haul.

A publication of:

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Which Business Structure is Right for Your Business?

It is commonly heard around the truck stop, that owner-operators save thousands of dollars after they incorporate their business. You could save from incorporating, but you should not rush into this important step in the life of your business.

The legal form under which you set up your business can have a significant impact on the way you run your operation, the costs of running your operation, and how you are taxed.

Which Business Structure is Right for Your Business?

It is critical to understand the business structure options available and when each is most appropriate for your business.

From this ebook, you will learn which structure has the best options for your business and which will save you the most money.

Meet the Author - Chris Goodsell

Chris Goodsell started at ATBS in August 2005. Prior to ATBS, he worked at Werner Enterprises as a Fleet Manager. Chris has a Bachelor of Science Degree in Business Management from Wayne State College. He also has taken income tax preparation classes. In addition to his work as a business consultant, Chris prepares tax returns for ATBS clients during tax season. Chris likes to play and watch sports, especially Huskers sports. He also enjoys spending time with his son.

You should understand the advantages and disadvantages of each structure before making choices in your own business.

There are small differences in the way each are set-up, must be managed, and how you must file your taxes that can make a huge difference to your business.

Continue reading to learn the most common business structures with an explanation, advantages, and disadvantages of each.

Sole Proprietorship

A sole proprietorship is a business owned by one person.

Advantages: A Sole proprietorship is the least expensive, easiest, and least regulated type of business structure. There is no formal setup and it begins when you start earning revenue as an owner-operator.

In the eyes of the law, the owner of a sole proprietorship is the business, and the business is the owner.

Sole Proprietorship Cont.

Debt incurred by the business is also the debt and responsibility of the owner. Because of this, income taxes are fairly simple. Since you and the business are one and the same, the business ends when you quit operating as an owner-operator.

Disadvantages: This form of business does not protect you personally from legal liability. However, carrying the proper insurance should protect you from significant losses in the event of accident liability.

Partnership

A partnership is similar to a sole proprietorship but more than one person owns it.

The individuals forming the partnership are taxed separately as they would be if they were sole proprietors. A partnership is also easily formed but a written agreement is strongly recommended to clearly outline the role of each partner and the distribution of profit and loss. It should also formally spell out how you and your partner/ partners will resolve conflict.

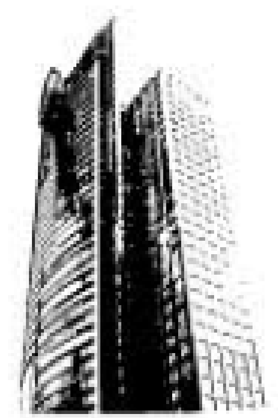
Partnership Cont.

Advantages: Having access to extra start-up capital, gaining assistance or expertise in some aspect of your business, or having a co-driver who can help increase the miles driven. To be successful, co-driving partners should be compatible socially and professionally.

Disadvantages: Like a sole proprietorship, the partnership is not personally protected from legal liability. In addition, it is important to remember that each partner is held personally liable for the actions of the others in the partnership.

Corporation

Unlike sole proprietorships and partnerships, a corporation is treated as a separate entity from its owners, shareholders, and employees. Shareholders are individuals who own one or more shares of your corporation, which can entitle them to voting rights or a share of the business profits. Incorporation laws differ from state to state and the cost can be from a few hundred dollars to a few thousand to set up the corporation. Incorporating also involves numerous forms, records, and formal meetings.



Corporation Cont.

A corporation must have a checking account that is used for business purposes. Some corporate assets must exist and they must be kept separate from the owner's personal assets. The law requires a corporation to elect officers, hold regular (usually quarterly but at least annual) meetings and take minutes for those meetings.

There are two main ways corporations are taxed. These are C Corporations and S Corporations.

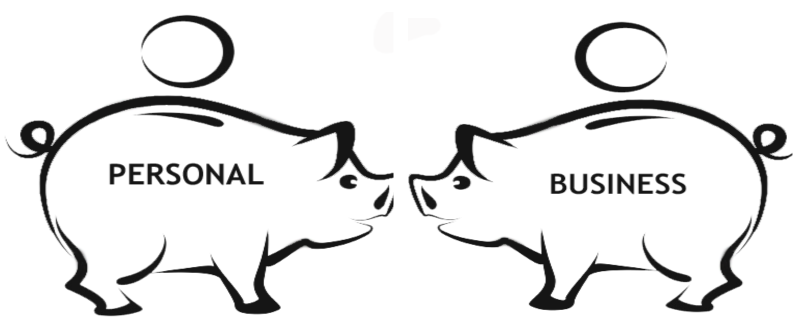
“C” Corp

This corporation is its own entity and pays taxes on the income it earns after all expenses and wages have been deducted. The driver is an employee of the C Corporation and receives a paycheck – a salary – from the corporation. The amount of the salary the driver pays himself must be reasonable based on the services performed. The Corporation is allowed a tax deduction for the reasonable salary and the driver pays personal income tax on what the corporation has paid him.

“C” Corp Cont.

Advantages: Because the driver is considered an employee, the corporation offers personal liability protection for the driver. The personal liability protection that is afforded a driver is a significant advantage because if your business is sued, your personal assets cannot be allocated with the business.

***It is important to create a separate bank account to manage the income and expenses of your business. In the event of an IRS audit or if your business is sued, having your personal finances mingled with your business could cost you thousands of dollars.**



“C” Corp Cont.

Disadvantages: If the driver withdraws any part of the profits of the corporation, over and above the salary, it is usually considered a dividend. The C Corporation has paid corporate taxes on the profits. The shareholder may withdraw profit as a dividend and when the dividend is taken, it is also taxed at the shareholder’s personal level. This is known as double taxation.

“S” Corp

S Corporations are not subject to tax at the corporate level. Instead, all corporate profits and losses flow directly to the shareholders of the S Corporation and are included on the shareholder’s personal income tax return. As a result, the corporate profits are taxed at the personal level. Net income in excess of officer salaries is distributed to the shareholders and is not subject to self-employment tax. The shareholder will still pay income taxes on the distribution.

“S” Corp Cont.

The driver is set up as an employee of the S Corporation and receives a salary from the corporation. The amount of the salary the driver pays himself must be reasonable based on the services performed. The S Corporation is allowed a tax deduction for the reasonable salary and the driver reports the salary as income on his personal income tax return.

Advantages: This type of corporation offers the limited liability of a C Corporation without the double taxation.

Disadvantages: Owner-operators are tempted to set up corporations to avoid liability, protect assets and avoid taxation. However, if a court finds that the company is not being operated as a corporation and not following all corporate rules and regulations, the owner may find himself personally responsible for debts, lawsuits, taxes and penalties incurred by the corporation.

Incorporating is not a good choice for most owner-operators because the costs of incorporating will exceed the benefits (unless the owner-operator is at a higher net income level.)

"S" Corp Cont.

Following the rules and the laws for incorporating takes time, effort, understanding, and may not be worth the investment of your resources.

Limited Liability Company - LLC

A limited liability company may offer benefits similar to an S Corporation. It offers the limited liability advantages of a corporation with the tax status of a sole proprietor.

Advantages: Taxes for the LLC are prepared using a Schedule C on the individual's personal tax return. This means no double taxation. LLCs are also simpler and more flexible than a corporation. Formal meetings, records and many of the forms needed to create a corporation are not required when setting up and operating an LLC.

“LLC” Cont.

An LLC may elect to be taxed as an S Corporation. Just as a Corporation must elect to be taxed as an S Corporation, an LLC must file the same election. By electing to be taxed as an S Corporation, an LLC can receive the same tax benefits of a Corporation taxed as an S Corporation. However, an LLC does not have the same on-going requirements as corporations.

***ATBS, the largest business services provider in the U.S., recommends to almost every client to form an LLC and file their taxes as an s-corporation.**

“LLC” Cont.

Disadvantages: Every state treats LLCs differently, which means that an LLC set up in one state may not provide liability protection in another. A LLC can also be expensive to set up, sometimes more than setting up a corporation. LLCs do not offer significant tax advantages but are created to limit the liability of the owner of the LLC.

Limited Liability Partnership - "LLP"

In most states, a business can be set up as a limited liability partnership providing liability protection for all of the general partners as well as management rights in the business for each. It is similar to an LLC except that there is more than one owner.

Advantages: Profits of the LLP are not directly taxed but are taxed at the individual partner level based on the dividends distributed to each partner.

"LLP" Cont.

Disadvantages: A LLP is expensive to establish and more complicated than other forms of business. It requires extensive documentation outlining the partnership agreement and if a LLP drops or loses a partner, the business is automatically deemed dissolved. As with the LLC, every state treats LLPs differently and this may affect the LLP's liability in certain states.

Chapter 2 - Comparing Each Business Structure

Business Struckture	Pros	Cons
Sole Proprietorship	• Inexpensive • Easy to set up • Little regulation	• No personal liability protection
Partnership	• Easily formed • Access to extra startup capital • Assistance & additional expertise	• No personal liability protection
"C" Corp	• Peronsal liability protection	• Costly to setup • Must follow rules and regulations • Double taxation
"S" Corp	• Peronal liability protection • No double taxation	• Costly to setup • Must follow rules and regulations
"LLC"	• Personal liability protection • Tax status similar to a sole proprietorship • Can be taxed as an S Corp	• Can be expensive to setup • LLCs are treated differently by every state, which may affect liability protection
"LLP"	• Peronsal liability protection • Taxed at individual partner level	• Expensive and complicated to setup • Extensive documentation required • LLPS are treated dfferently by every state which may affect liability protection • Loss of partner autoatically dissolved LLP

When Does it Make Sense to Incorporate?

The following table indicates the income tax, Social Security and Medicare taxes, and self-employment tax that would be due under three forms of business organizations. For purposes of simplification, this example assumes that the taxpayer is single with no dependents, does not itemize deductions, and lives in a state that has no state income tax or entity franchise tax.

	Sole Proprietors	"S" Corp	"C" Corp
Gross Earnings	$70,000	$70,000	$70,000
Salary		$36,000	$36,000
Personal Income Tax	$10,114	$10,082	$10,082
Self-Employment Tax	$9891		
Social Security/Medicare** Taxes		$5,508	$5,508
Corporate Income Tax			$5,250
Total Taxes Due	$20,005	$15,590	$20,840

*For purposes of this illustration, it is assumed that the profit remaining in the corporation after salary was distributed as a dividend.
**This amount includes both employer and employee portions of these taxes.

When Does it Make Sense to Incorporate? Cont.

As you can see, a S Corp provides the lowest tax liability. It would appear that this would always be the best alternative; however, consideration must be given to the costs both in time and money to set up and run a corporation.

There are initial formation fees, filing fees and annual state fees, which can run $1,600 - $2,300 per year. There are also additional costs for filing corporate tax returns and monthly costs for payroll. A corporation must also have regular meetings, record minutes and keep the records of the corporation.

When Does it Make Sense to Incorporate? Cont.

Failure to follow the requirements of the corporation could result in losing the limited liability production the corporation provides.

Let's look at a second example with a lower net income.

In the following example there is a net profit of $40,000 and a salary drawn of $36,000 in the corporations. As in the previous example, assume that the taxpayer is single with no dependents, does not itemize deductions, and lives in a state that has no state income tax or entity franchise tax.

When Does it Make Sense to Incorporate? Cont.

	Sole Proprietors	"S" Corp	"C" Corp
Gross Earnings	$40,000	$40,000	$40,000
Salary		$36,000	$36,000
Personal Income Tax	$3,756	$3,419	$3,419*
Self-Employment Tax	$5,652		
Social Security/Medicare** Taxes		$5,508	$5,508
Corporate Income Tax			$3,000
Total Taxes Due	$9,408	$8,927	$12,927

*For purposes of this illustration, it is assumed that the profit remaining in the corporation after salary was distributed as a dividend.

**This amount includes both employer and employee portions of these taxes.

In both of the examples, an S Corporation provides the lowest tax liability for an individual. However, let's compare the tax savings in each instance between a sole proprietorship and an S Corp, after we consider the average costs for setting up and running a corporation.

When Does it Make Sense to Incorporate? Cont.

	Net Income of $70,000	Net Income of $40,000
Salary	$36,000	$36,000
Tax as Sole Proprietor	$20,005	$9,408
Tax as “S” Corp	- $15,590	- $8,927
Tax Savings with “S” Corp	$4,415	$481

As you can see, the average yearly costs of incorporating ($2,300) are more than the tax savings of $481 at the lower income level. The S Corporation makes sense for the owner-operator making a net profit of $70,000 but not for the owner-operator making a net profit of $40,000, which is why incorporating only makes sense at higher net income levels.

Chapter 3 - Deciding When to Incorporate.

ATBS recommends forming an LLC and being taxed as an S-Corporation for almost every owner-operator. This method offers the same tax benefits as a Corporation but is taxed as an S-Corporation.

- Having a LLC means you are not required to have:
  - Corporate by-laws
  - Issue stock
  - Have annual meetings, etc.

Want Help Incorporating Your Business?

Incorporating is an important step in the life of your business and one that can result in significant tax savings for you.

ATBS, the largest owner-operator business services provider in the US, can help get every legal tax benefit available. ATBS can help you set up a corporation properly and will also help you adhere to all aspects of corporate laws, so you never jeopardize the personal liability protection gained through incorporating.

Call (888) 640-4829 or go to www.teamrunsmart.com/free-ebook to get started saving money today!