CHAPTER 1

What Legal Entity Should I Be?

As a practicing business attorney for 18 years, I have heard it all when it comes to incorporating a business. Many think that incorporating their business will help them cut the federal tax bill or avoid paying state income taxes completely. First-time entrepreneurs often have misconceptions about incorporation, usually resulting from an optimistic desire for lower taxes or third-hand advice from a friend or a friend's accountant. When small business owners fall prey to some of these myths, the consequences can range from higher taxes to misunderstanding their personal liability. To gain a better understanding of these myths, it's important that you understand some of these misconceptions surrounding incorporation.

- **Incorporating can help with avoiding state taxes:**
  Those starting a business in California might be jealous of neighbors in Nevada who don't have to pay state income taxes. Many entrepreneurs believe that they can incorporate in a low tax or no tax state and their business is not required to pay any income taxes. It sounds like a great strategy but it does not work. When it comes to state taxes, it does not matter where the business is incorporated. What generally matters is where the owner operates the enterprise. Those living and running a business in California still need to pay state taxes on the income earned in California even if the company is incorporated in Nevada. Moreover, Nevada requires an annual filing of the list of officers and directors of the corporation and requires a business license. These fees can add up very quickly and outweigh the benefit of paying no state taxes.

- **Incorporating protects the owner from all personal liability:** Incorporating is a critical step for separating an owner from the business, but it does not absolve the owner of all personal responsibility. As the proprietor of a business, the owner can still be held personally liable for the business in several situations. If a business proprietor signs a contract in the owner's personal name, personally guarantees a loan, does not keep up with corporate compliance paperwork, or commits a crime, the owner will be personally liable.
- **It's better to wait until a product is ready for the marketplace:** Many small business owners prefer to avoid legal paperwork until they absolutely have to deal with it. Some believe there is no need to incorporate until they start selling a product or service. This line of thinking is wrong on two counts: First, liability issues related to a business can arise long before products hit the marketplace; for example, an employee, independent contractor, or vendor might sue the owner for related reasons. The second reason to incorporate early is related to an owner selling the company, as it's more desirable to treat the sale proceeds as long-term capital gains than ordinary income. The stock in your company must be held for more than one year.

Make no mistake, it is critical to form a corporation for entrepreneurial activities to minimize personal liability. In some cases, these business legal entities can lower taxes, but incorporating should never be considered an easy way to avoid taxes.

Before I explain which legal entities exist and which one would be a good fit for you, it's important to understand what exactly is a startup.

What Is a Startup?

Merriam-Webster's dictionary defines a startup as "the act or an instance of setting in operation or motion." This is not a helpful definition to the newly formed business. The reality is that there is no one definition any two entrepreneurs or business owners agree on. Most say a startup is determined by its age, growth, revenue, profitability, or stability. Neil Blumenthal, co-CEO of Warby Parker, defines a startup as "a company working to solve a problem where the solution is not obvious and success is not guaranteed." Another entrepreneur, Adora Cheung, CEO of Adora, stated: "A startup is a state of mind. It's when people join your company and are still making the explicit decision to forgo stability in exchange for the promise of tremendous growth and the excitement of making immediate impact." The Small Business Association sums up the word startup, "In the world of business, the word 'startup' goes beyond a company just getting off the ground. The term startup is also associated with a business that is typically technology oriented and has high growth potential. Startups have some unique struggles, especially in regard to financing. That's because investors are looking for the highest potential return on investment, while balancing the associated risks."

The best definition of a startup was provided by Alyson Shontell while she was the editor-in-chief of *Business Insider US*. "A startup is an emotional roller coaster that can either result in massive failure or success, after which one's bank account total may either drastically increase or decrease. The person behind a startup is a founder, an often very bright, somewhat crazy person who finds a normal 9-to-5 job dull and is deluded into believing he or she can change the world by working tirelessly in front of a computer screen. The relentless work has been known to shave a few years off a founder's life while adding premature gray hairs, but it can be very rewarding both emotionally and financially for those who pursue it." I could not agree more with Alyson Shontell's definition.

Now that we have a definition of what a startup is, I can answer the number one most frequently asked question in the Startup phase.

What Legal Entity Should I Be?

When starting out, it is important to determine what form of business structure will work best for your specific situation. Choosing the best legal structure for your business requires knowledge of your line of work and understanding of local state and federal laws. The legal structure you choose for your business is one of the most important decisions you will make in your startup process. Your choice of structure can greatly affect the way you run your business, impacting everything from liability and taxes to control over the company. Choosing the right business entity allows an entrepreneur to reduce liability exposure, minimize taxes, and ensure that the business can be financed and run efficiently. It also provides business owners with a mechanism for ensuring that the business operations will continue, rather than be automatically terminated, upon the death of an owner.

When choosing a business entity, you should consider the following:

- Are your personal assets at risk from liabilities arising from your business?
- Are you able to offer ownership to key personnel?
- What are the continued costs of operating and maintaining your business?

Here is a list of the most commonly used legal structures for business and the advantages and disadvantages of each one is explained in detail below.

Common Legal Entities:

- Sole Proprietorship
- Partnership
- Limited Liability Company – including: Series LLC
- Corporation – including:
  - C Corporation
  - S Corporation
  - Close Corporation
  - Benefit Corporation
  - Professional Corporation
  - Nonprofit Corporation

Sole Proprietorship

The most common and simplest form of business is a sole proprietorship. Many small business owners launch their companies as sole proprietorships, in which they and their business are essentially one and the same. An individual proprietor owns and manages the business and is responsible for all business transactions, including its debt. If you want to be your own boss and run a business from home without a physical storefront, a sole proprietorship allows you to be in complete control. Sole proprietorships do have some advantages. They are quick and easy to set up, as no paperwork is required to be filed with the state, they do not require large amounts of money, and accounting is relatively simple. However, sole proprietorships have many disadvantages as well.

The biggest disadvantage is that there is no separation between the assets of the business and the owner's personal assets. This means that anyone who sues the business for any reason can potentially receive a judgment for the business owner's personal assets, such as cash kept in personal checking or savings accounts, the family car, or even the business owner's home. Another big disadvantage occurs if the sole proprietorship wants to borrow money. Because there is no separation between business and personal assets, many sole proprietors have to use their personal assets, such as their home, as collateral for a loan. If the business fails and the owner does not have enough money to pay off the loan, the lender can take the owner's home and sell it to get its money back. Needless to say, this type of ownership is the riskiest and, to make things worse, the courts do not see any difference between a sole proprietorship and its owner. So, when the owner passes away, the business ends.

Partnership

Other forms of business ownership include forming a partnership. This entity is owned by two or more individuals. There are two types of partnerships: a general partnership, where all is shared equally including the assets, profits, liabilities, and management responsibilities between the partners; and a limited partnership, where only one partner has control of the operations while the other partner contributes to and receives part of the profits. A partnership is ideal for anyone who wants to go into business with a family member, friend, or business partner. This entity allows the partners to share profits and losses and make decisions together. Having a well-drafted partnership agreement by an attorney is advisable so all the partners can be held responsible for their contributions, or lack thereof.

While general partnerships provide a means of raising capital more quickly and allow several people to combine resources and expertise, several problems commonly occur, such as partners having different visions or goals for the business, an unequal commitment in terms of time and finances, and personal disputes. Some advantages of a general partnership are shared financial commitment, the ability to pool resources, and generally, limited startup costs. Some disadvantages of a general partnership include partners being personally liable for business debts and liabilities, and each partner may also be liable for debts incurred by decisions made and actions taken by the other partners.

Limited Liability Company

A limited liability company (LLC) is a unique business entity that allows the owners to limit their personal liability while enjoying the tax and flexibility benefits of a partnership. Under an LLC, the members (owners) are protected from personal liability for the debts of the business, as long as it cannot be proved that the members have acted in an illegal, unethical, or irresponsible manner in carrying out the activities of the business.

Limited liability companies were created to provide business owners with the liability protection that corporations enjoy while allowing earnings and losses to pass through to the owners as income on their personal tax returns, thus avoiding double taxation (which is covered in the corporation section below). LLCs can have one or more members and profits and losses do not have to be divided equally among the members. There is a state filing required to form an LLC and although not required by law, drafting an operating agreement is highly advised as it is a crucial document. The operating agreement customizes the terms of the LLC according to the specific needs of its owners, along with outlining the financial and functional decision-making among the members. Businesses that do not have a signed operating agreement fall under the default rules outlined by the individual states, which can sometimes work against the wishes of the owners. In such a case, the rules imposed by the state will be very general in nature and may not be right for every business. For example, in the absence of an operating agreement, some states may stipulate that all profits in an LLC are shared equally by each member regardless of each member's capital contribution. This may not be fair to the members who have contributed a lot more money as opposed to the members who only contributed a fraction of the money.

Many states do not offer this next structure but it's worth mentioning as it is part of an LLC structure – a Series LLC. A Series LLC is a unique form of a limited liability company in which the articles of formation specifically allow for unlimited segregation of membership interests, assets, and operations into independent series. Each series operates like a separate entity with a unique name, bank account, and separate books and records. A Series LLC may have different members and managers in each series. The rights and obligations of these members and managers differ from series to series. Each series may enter into contracts, sue or be sued, and hold title to real and personal property.

The most important characteristic of a Series LLC is the liability protection that is available to each series. Assets owned by one series are shielded from the risk of liability of other series within the same Series LLC. A Series LLC is similar in concept to a corporation with several subsidiaries. However, the Series LLC concept is designed to segregate risk within separate entities without the cost of setting up new entities. The Series LLC is a creation of the individual states and only in certain states are Series LLCs allowed to be formed. Delaware was the first state to enact legislation authorizing the creation of Series LLCs. Several states and one territory have followed suit, including Illinois, Iowa, Nevada, Oklahoma, Tennessee, Texas, Utah, and Puerto Rico. Some states, like California, do not allow the Series LLCs to be formed under state law but Series LLCs formed in other states can register with the state of California and do business in California.

Corporation

The law regards a corporation as a legal entity that is separate and distinct from its owners. Corporations enjoy most of the rights and responsibilities that an individual possesses; that is, a corporation has the right to enter into contracts, loan and borrow money, sue and be sued, own and sell property, hire employees, own assets and pay taxes, and sell the rights of ownership in the form of stocks.

Corporations are used throughout the world to operate all kinds of businesses. While their exact legal status varies somewhat from jurisdiction to jurisdiction, the most important aspect of a corporation is the limited liability protection. This means that shareholders have the right to participate in profits but are not held personally liable for the company's debts.

There are several different types of corporations, including "C" Corporations, "S" Corporations, Close Corporations, Benefit Corporations, Professional Corporations, and Nonprofit Corporations. There are many differences between them and an understanding of each is required to decide which one is right for you.

C Corporation

A C Corporation is a business term that is used to distinguish this type of entity from others, as its profits are taxed separately from its owners under subchapter C of the Internal Revenue Code. This is known as "double taxation," whereby the C Corporation is taxed on its earnings or profits and the shareholders are taxed again on the dividends they receive from those earnings. A C Corporation is owned by shareholders, who must elect a board of directors who make business decisions and oversee policies. Because a corporation is treated as an independent entity, a C Corporation does not cease to exist when its owners or shareholders change or die. Some of the major benefits of a C Corporation include:

- Its owners (known as shareholders or stockholders) enjoy limited liability and they are generally not personally liable for the debts incurred by the corporation. They cannot be sued individually for corporate wrongdoings.
- It can deduct the cost of benefits as a business expense; for example, it can write off the entire costs of health plans established for employees.
- The corporate profits can be split among the shareholders and the corporation. This can result in overall tax savings, as the tax rate for a corporation is usually less than that for an individual.
- It can have an unlimited number of shareholders, as this allows the corporation to sell shares to a large number of investors, and allows for more funds to be raised.
- It allows for foreign nationals to have a right to own or invest in a C Corporation, which allows for diverse investors to participate in the business.
- It can offer different "classes" of stock, such as common or preferred, to different shareholders, which can help attract different groups of investors.

S Corporation

An S Corporation stands for "subchapter S corporation," a special tax status granted by the Internal Revenue Code that allows corporations to pass their corporate income, credits, and deductions through to their shareholders. Generally speaking, S Corporations do not pay income taxes as the company's individual shareholders divide the income among each other and report it on their own personal income tax returns. An S Corporation status lets businesses avoid double taxation, which is what happens when a business is taxed at both the corporation level and business owner level, such as with a C Corporation. An S Corporation must adhere to the following limitations:

- It must be a domestic corporation, which is based and operated in the United States of America.
- It can only have "allowable" shareholders, meaning that none of the shareholders can be partnerships, other corporations, or non-U.S. citizens.
- It cannot have more than 100 shareholders in total.
- It can only have one class of stock: common.
- All of the company's shareholders must unanimously consent to an S Corporation status.

An S Corporation offers several advantages, such as:

- It is exempt from federal income tax except for certain capital gains and passive income. It allows profits to pass through to its shareholders and the income is then taxed on the shareholder's personal tax returns at each shareholder's individual tax rates.
- It allows for limited liability protection for personal assets that are separate from the assets of the business. Shareholders are not personally liable for the company's debts or liabilities, and for the most part, creditors are not able to go after the shareholders personally to recover business debts.
- It allows for flexibility in how to characterize the income for tax purposes. As a shareholder of a corporation, you can also be an employee of the business and pay yourself a salary, which is taxed at your tax rate. In addition to your salary, you can pay yourself dividends from the corporation that are generally taxed at a lower rate than the employee salary. This helps reduce self-employment tax liability, as long as you are characterizing your salary and dividend in a reasonable way.
- It allows for easy transfer of ownership without causing significant tax consequences or terminating the corporate entity.

Close Corporation

A Close Corporation, also known as a family corporation, is generally a smaller corporation that elects close corporation status and is therefore entitled to operate without the strict formalities normally required in the operation of standard corporations. Many small business owners find this benefit invaluable. In essence, a Close Corporation is a corporation whose shareholders and directors are entitled to operate much like a partnership. The Close Corporation election is made at the state level and the state laws vary with respect to the eligibility of close corporation status and with respect to the rules governing them. Some states do not authorize them. The requirements to be eligible for a Close Corporation status include: no more than 30 to 35 shareholders, it cannot make a public offering of its stock, and shareholders must agree unanimously to a close corporation status. Close Corporations enjoy relaxed rules with respect to the formalities of governance, such as shareholders typically need not hold formal annual meetings and the shareholders may override the directors and act on their own.

Benefit Corporation

A Benefit Corporation is a relatively new type of business entity. Originally implemented by legislation in Maryland in 2010, this new entity is now recognized in half the states, while legislation is pending in many others. A Benefit Corporation is a for-profit corporation entity that in addition to profit also takes society and the environment into consideration when making decisions. The goal of this corporate structure is to encourage for-profit companies to identify social missions and demonstrate corporate sustainability efforts. To be recognized as a Benefit Corporation the company must include:

- Purpose: Benefit Corporations commit to creating public benefit and sustainable value in addition to generating profit. This sustainability is an integral part of their value proposition.
- Accountability: Benefit Corporations are committed to considering the company's impact on society and the environment in order to create long term sustainable value for all shareholders.
- Transparency: Benefit Corporations are required to report to their shareholders, and in most cases the wider public, in most states annually and using a third-party standard, showing their progress toward achieving social and environmental impact.

Becoming a Benefit Corporation has advantages for everyone in and related to your business, from shareholders and directors to your customers. These benefits include:

- Expanded Shareholder Rights: Investing in a Benefit Corporation gives impact investors the assurance they need that they will be able to hold a

company accountable to its mission in the future. This could aid companies in attracting impact investment capital.
- Reputation for Leadership: Your business will join other high profile, highly respected companies as Benefit Corporations and be at the forefront of a growing movement.
- Attracting Talent: According to *Inc. Magazine* writer Peter Economy, by 2020, Millennials (those born between about 1980 and 2000) are forecast to represent half of the American workforce, and by 2025, 75% of the global workforce. Benefit Corporation status gives prospective employees confidence that a company is committed to their mission.
- Increased Access to Private Investment Capital: Benefit Corporation status can make your company more attractive to investors as a company with increased legal protection, accountability, and transparency around its mission. Benefit Corporations can also speed up investor due diligence, since they produce an annual benefit report, which describes their qualitative activities aimed at producing general public benefit.

Professional Corporation

A Professional Corporation, also known as "APC" or "PC" was created to allow certain kinds of professionals such as lawyers, doctors, accountants, and engineers to do business as a Professional Corporation. In each state, specific types of professionals are allowed, and in some states required, to form a Professional Corporation. For example, in California, professionals are required to form a Professional Corporation and therefore cannot be an LLC. Professional Corporations are different from the C or S Corporations because all shareholders in a Professional Corporation must be members of the same profession involved in the same business. For example, a group of lawyers can form a Professional Corporation if their business is to practice law. While there is some limitation on liability surrounding the actions of each partner, the professionals in the firm may not be relieved of liability of their own professional negligence or malpractice. This is the main reason professionals form this type of corporation. They can enjoy sharing management responsibilities and profits without exposing themselves to malpractice actions against the other owners.

Nonprofit Corporation

A Nonprofit Corporation is an organization whose purpose is something other than making a profit. A Nonprofit Corporation donates its revenue to achieve a specific goal that benefits the public instead of distributing it to shareholders. Being a nonprofit does not mean the organization will not make a profit. Nonprofits can make money but all of the money must go back to the organization by paying employee salaries, administrative expenses, and other overhead costs. No one person or group owns a nonprofit. While anyone can incorporate as a nonprofit, only those who pass the stringent standards set forth by the government can achieve tax exempt status.

Nonprofit Corporations are established for a specific noncommercial purpose, which usually includes churches, schools and universities, hospitals, museums, and shelters. There are four main types of nonprofits and each contains the ability to achieve tax exempt status despite their slightly different goals and corporate structure. They include:

- Public Charities: Typically, a charity provides low cost or free services to the public using funds received from the public. Funds can be obtained through private donations or fundraising events.
- Social Advocacy Organizations: This type of group is member based and sets out to achieve specific goals without achieving a profit. Funds are generated through member dues.
- Foundations: This type of organization works to better the community, whether contributing financially or as local charities holding events to benefit residents. Funds usually come from for-profit companies.
- Trade and Professional Organizations: People in the same organization can benefit from the activities of this type of nonprofit. Funds are primarily obtained through membership dues.

What Factors Should I Consider Before Choosing a Business Structure?

When deciding to set up a new entity for your startup, you should consider your startup's financial needs, risk, and the ability to grow. Here are some factors to consider when choosing the legal structure for your business, and always consult with your accountant, as these structures have very different tax implications:

- **Complexity:** How complex is your business and what entity best addresses your needs? When it comes to startup and operational complexity, nothing is simpler than a Sole Proprietorship. You simply register your company name, start doing business, report the profits, and pay taxes. However, you are personally liable for all debts of your company and it can be very difficult to procure outside funding in case you need money to purchase equipment or grow your business. Partnerships, however, require a signed agreement to define the roles and percentages of profits, but partners are still personally liable for the partnership debts. Corporations and LLCs have various reporting requirements with state and federal governments, but they offer limited liability protection for the shareholders and members.

- **Liability:** Is the entity you are forming protecting your personal assets from your business assets? A Corporation carries the least amount of personal liability since the law holds that it is its own entity. This means, generally, creditors can sue the Corporation but they cannot sue you personally to obtain access to your personal assets. An LLC offers the same limited liability protection but with the tax benefits of a Sole Proprietorship. If the business tax is lower than your personal tax bracket, forming an LLC is not always the best option. However, in some situations, an LLC may elect to be taxed as a Corporation. Partnerships share the liability between the partners as defined by their partnership agreement.
- **Flexibility:** Where is your company headed and which type of legal structure allows for the growth you envision? It is recommended that before you start your business, you should invest some time drafting a business plan. The benefits of a business plan are discussed at length in Chapter 7. Turn to your business plan to review your goals and see which structure best aligns with those objectives. Your entity should support the possibility for growth and change.
- **Taxes:** Will this entity provide the best tax benefits for your business? An owner of an LLC pays taxes just as a sole proprietor, whereby all the profit is considered personal income and taxed accordingly at the end of the year, unless you elect to be taxed as a corporation. As a small business owner, you want to avoid double taxation in the early stages and an LLC structure prevents that along with an S Corporation. Individuals in a partnership also claim their share of profits as personal income. Both C Corporations and and S Corporations file their own tax returns each year, paying taxes on profits after expenses, including payroll.
- **Control:** Who will have control over your business, and how do you maintain the majority control? If you want sole or primary control of the business and its activities, a Sole Proprietorship or an LLC might be the best choice; however, you are opening yourself up to personal liability. A Corporation has a board of directors that makes the major decisions that guide the company. It also has shareholders who have voting power. A single person can control a corporation, especially at its inception, by being the majority shareholder, but control of a company is shared with the board of directors.
- **Capital Investment:** Will you need outside investment money to start and run your business? If you need to obtain outside funding, such as from an

investor, venture capitalist, or a bank, you may be better off establishing a Corporation. Corporations have an easier time obtaining outside funding than a Sole Proprietorship. Corporations can sell shares of stock and secure additional funding for growth, while sole proprietors can only obtain funds through their personal accounts using their personal credit or taking on partners.

- **Licenses, Permits and Regulations:** Will the licenses and permits be held in the name of your business? In addition to legally registering your business entity, you may need specific licenses and permits to operate. Depending on the type of business and its activities, it may need to be licensed at the local, state, and federal levels.
- **Changing a Sole Proprietorship:** Changing a Sole Proprietorship or a General or Limited Partnership to a Corporation or a Limited Liability Company can offer a range of advantages. Most notable is asset protection: An S or C Corporation or an LLC protects the owner's personal assets in case debts or legal judgments are claimed against the business.

What Are Some Advantages of Incorporating?

Owning a small business can be a risky venture. One way to limit your personal liability is by incorporating your business. While incorporation requires more paperwork and expense than a Sole Proprietorship or a Partnership, it offers important legal and tax advantages. Either way, incorporating is a good decision for most businesses, and despite popular belief, it is not just reserved for those that are wealthy businesses and well established. There are multiple benefits of incorporating, all of which you should fully understand before you decide to make your move.

Some of the most popular reasons why incorporating your business should be a priority are:

- **Protect your personal assets from creditors:** There is no doubt that starting your business is exciting, but with that excitement comes the reality that accidents happen and unfortunately businesses sometimes fail. This is where one of the best benefits of incorporating comes into play. By incorporating your business, albeit as a C or S Corporation, or an LLC, you are protecting your personal assets from business debts. If your business falls on hard times, your personal property is off limits to collection agencies. For example, if you cannot pay your business loan any longer, generally, the bank will not be able to come after your home to satisfy the loan. If you have not yet incorporated your business, your personal assets are linked automatically to your business. This may include your car, your home, your investment accounts, and even assets you obtain in the future. Additionally, if you were to file bankruptcy within your business, your personal assets would be used to repay your debt. By incorporating you protect your business from this, which is probably one of the most valuable benefits of incorporation.

- **Protecting your personal assets from lawsuits:** Along with the protection from creditors comes protection from lawsuits filed against your business. Without incorporating, your personal assets remain at risk to anyone filing a lawsuit against your business. These individuals could try to collect on a judgment against you, for example, by taking possession of your home. That means if a customer trips and slips in your store and takes you to court to collect damages, you are personally liable. Incorporating, however, creates a solid barrier between your personal assets and the claims of others. That means if your business is sued, the safety of your personal and family possessions is not at risk. As a responsible businessperson you never want to be caught unprepared. The benefits of incorporating lead specifically to keeping your business operational and the security of yourself and your family intact.
- **Tax benefits and money savings:** Another benefit of incorporating your business, and one of the most crucial to leverage, is the many tax deductions that are available to incorporated businesses. When you go from being a Sole Proprietor or Partnership to a business structure such as an LLC or an S or C Corporation, there are numerous deductions at your disposal that are not available to individuals. Everything from tax deductions on health insurance and life insurance, to saving on self-employment taxes. Side bar: Tax laws are complex, and it is in your best interest to consult with an accountant before claiming any deductions.
- **Easier to raise capital:** It might not be the most obvious benefit of incorporating, but it is true that by incorporating you are making it easier for your business to raise capital. This mostly means that if you plan on borrowing money or applying for a loan, it adds a sense of legitimacy to your business. If you want to accept money from outside investors, you simply sell stock of your company and if you want to borrow from banks, the lenders are more likely to loan you money because your business assets can be held as collateral.
- **Easier to sell:** Corporations and LLCs are generally much easier to sell and are usually more attractive to buyers than a Sole Proprietorship. This is mainly because a new buyer will want to limit their legal and tax exposure and not be personally liable for any wrongdoing on the part of the Sole Proprietorship. If someone buys a Sole Proprietorship, the new owner can be held personally liable for any mistakes or illegalities on the part of the prior

owner, even if the new owner had nothing to do with those activities. This is usually not the case with a Corporation or a Limited Liability Company.

- **Protect your brand:** Another benefit of incorporating your business has to do with your brand. Your brand is more than a logo or a marketing phrase. It is the way you operate your business, the look and feel of your location, and the type of products or services you offer. When you incorporate your business, it is not just your name you are protecting; you are also protecting the business overall image. You have worked hard to build your brand and image. By incorporating you can protect it from being used by others for their benefit.
- **Perpetual existence:** When you incorporate, you create a separate and distinct legal entity. This separate and distinct entity can exist almost forever, irrespective of what happens to the shareholders, directors, or officers. It is important to know your business can still be sold or that you may close it at some point. However, with the definition of a Corporation is the business's ability to remain in perpetual existence as its own entity. This important benefit matters because it gives you the ability to create a long-term plan for growth within the business. Investors want to know that your business can go on without you, legally, and it allows the business to remain operational without the need to reestablish itself. That being said, perpetual existence becomes a powerful and necessary tool for any business that wants to establish a strong foundation from which to grow. Corporations have unlimited life.
- **Transfer your business more easily:** Here's one of the benefits of incorporating that many people often miss. Let's say that you want to pass your business on to your child as you get older, but only want to do so in the event of a sudden illness. It is easier to transfer ownership when your business is a Corporation than it is if you are running a Sole Proprietorship. Remember, in a Sole Proprietorship, all of your personal assets are linked to your business. It is not possible to easily value your business for a sale or transfer it to another person until each of these lines of connections to your personal assets are defined and cut. Whether for short- or long-term goals, your business will benefit significantly from incorporating for this reason alone. There are some restrictions, of course, but transferring funds and even business ownership is easier when the business has its own identity.
- **Privacy and confidentiality:** Perhaps the most important benefit of incorporating for some people is the level of privacy that comes with incorporating your business. When you incorporate, you can keep your personal identity hidden. All of your business affairs are private and kept confidential unless you choose to disclose them. Some states do not even require your name to be on any business documents at all.

- **Increases credibility:** Both customers and venders feel more secure and confident dealing with an incorporated entity, be it a Corporation or an LLC as opposed to a Sole Proprietorship. Most businesses that are not incorporated actually miss out on gaining business from the bigger companies due to the fact that the giants of industry simply do not want to deal with individuals. If disputes occur, the giants do not want to be publicly viewed as the bully taking a small individual to court. Therefore, they just do not give their business to Sole Proprietorships. Having an "Inc." or an "LLC" after your company's name adds credibility and a touch of professionalism to your business dealings, and has the possibility to attract more business.

While it may not be necessary for all businesses to incorporate, most of the time, businesses do benefit from going through the incorporating process. It may seem like a daunting task at first, but with the help of GoLeglYourself.com tools, the process of incorporating is made easy.

If I Incorporate, Are My Personal Assets Protected from Lawsuits?

Once your company is incorporated, the limited liability protection afforded by the incorporation process is NOT automatic, meaning once you incorporate your business, your personal assets are not automatically protected from lawsuits. Ninety percent of business owners think they can enjoy the limited liability protection afforded to them by their incorporated entity. Incorporated entities do not automatically become barriers between your personal assets and your business assets whereby your personal assets are protected from lawsuits. The company actually must comply with corporate formalities in order to enjoy that limited liability protection for your personal assets. The protection afforded by incorporated entities is limited in nature because a Corporation is a separate entity and the law requires the business owner to treat it as such.

There are certain corporate compliance steps you must take in order for you and your company to enjoy limited liability protection under the law. Corporate compliance includes you treating your incorporated entity as completely separate from yourself. In most cases, you may only be one person running the company, but the law requires you to treat the company as if it is a completely separate entity from you. Moreover, failure to file required paperwork can lead to fines and penalties, including suspension of your incorporated entity.

The corporate compliance paperwork is key to keeping your company in good standing with the state where your company is incorporated. If your business is sued, the person suing may try to show the court that you have not maintained your business to the letter of the law, thus "piercing the corporate veil" and attaching your personal assets as part of a judgment. Piercing the corporate veil refers to a circumstance in which courts set aside limited liability protection and hold a company's owner personally liable for the organization's activities or debts. While the laws vary from state to state, courts will generally abstain from piercing the corporate veil unless there have been signs of serious misconduct.

Below is a general overview of what you should to do to keep your business in compliance with the law. Of course, specific requirements will vary based on your business type and location:

1. **File an annual report:** Most states require some sort of annual report filing on the anniversary of your incorporation date.
2. **File amendments for any changes:** If you make major changes to your corporation, you may need to keep your state up to date with filing Articles of Amendment. Examples of change include changes to the company name, changes to the registered agent, changes to the business address, an increase in the number of authorized shares, and changes in business activities.
3. **Keep up to date with any meeting minutes:** If your business is a Corporation, you'll need to record meeting minutes whenever you hold a corporate meeting. The bare minimum requirement regarding meeting minutes are the annual minutes, which appoint directors and officers.
4. **File a DBA for any name variations:** A lot of times, a business has an official name and then uses any number of variants of that name or in some cases uses different names to do business. In these cases, you should file a DBA (Doing Business As) with the county where you do business for each name used.
5. **Get an EIN:** You must obtain a Federal Tax Identification number, also known as an Employer Identification Number (EIN). An EIN is a unique nine-digit number that is as important for your company as a social security number is important for you personally. An EIN is used to open a bank account, register your company with various agencies, and file company taxes, and is required by clients who pay for your products or services.
6. **Separate bank accounts:** You will need to open a separate bank account for your incorporated entity that has its own checks and its own credit cards. This action separates your personal money from your business

money and prevents any commingling. Having a separate business account will make it easier for you to manage your business and show separation from personal assets, thus proof of a separate entity existence for your business. Additionally, this action will allow your incorporated entity to start creating its own credit rather than using your personal credit.

7. **Use full legal name:** The name of the corporation should be used in full, including "Inc." or "LLC," on all contracts, invoices, and documents used by your company. This clearly indicates the existence of the incorporated entity as a separate entity.
8. **Use your title:** Always use your title, such as President, Chief Executive Officer, or Secretary, when signing on behalf of your incorporated entity, as using the name of the corporation and your title further creates separation from you as an individual. Furthermore, if you were going to get sued, generally, by using your title, the person or entity suing you can only sue you as a corporate officer and not you as an individual person.

Key Takeaways

- When starting out, it is important to determine what form of business structure will work best for your specific situation. Choosing the best legal structure for your business requires knowledge of your line of work and understanding of local, state, and federal laws. The legal structure you choose for your business is one of the most important decisions you will make in your startup process. Your choice of structure can greatly affect the way you run your business, impacting everything from liability and taxes to control over the company.
- When deciding to set up a new entity for your startup, you should consider your startup's financial needs, risk, and the ability to grow. Take into consideration these factors when choosing the legal structure for your business and always consult with your accountant, as these structures have very different tax implications.
- Once your company is incorporated, the limited liability protection afforded by the incorporation process is NOT automatic, meaning once you incorporate your business, your personal assets are not automatically protected from lawsuits. Ninety percent of business owners think they can now enjoy the limited liability protection afforded to them by their incorporated entity. Incorporated entities do not automatically become barriers between your personal assets and your business assets whereby your personal assets are protected from lawsuits.