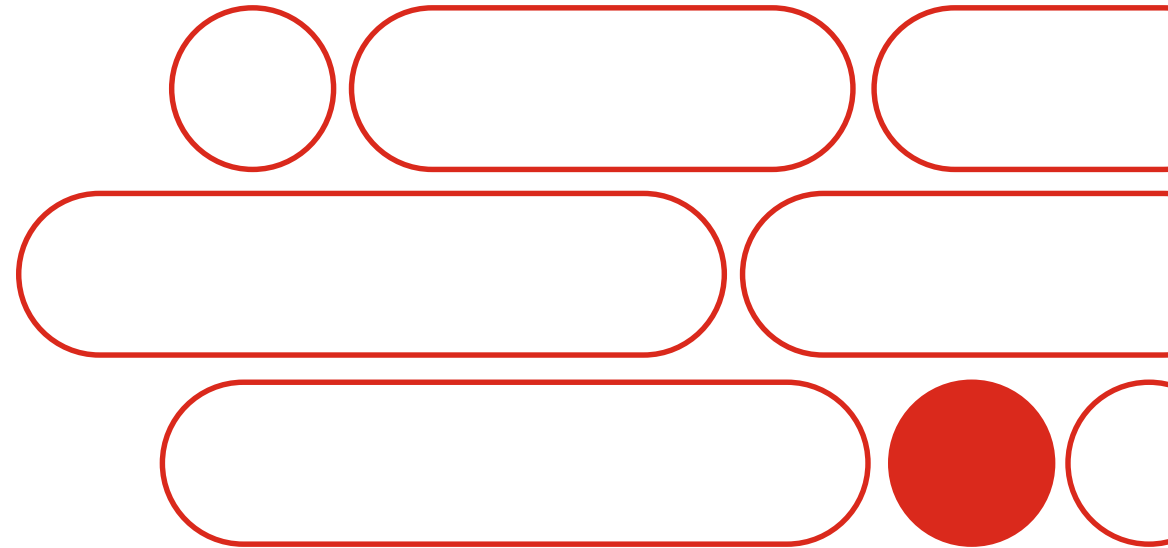


The Importance of Incorporation & How to Choose the Right Entity



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Incorporation Background

- New to the world businesses – 6 million form each year in US.
- 2.2 million New Businesses Incorporate every year
 - Percentage done online ~ 5.5%
- Most incorporate their business at the time of start-up*
 - 62% incorporated a start-up business
 - 26% incorporated an established business
 - 12% said their business was in-between at time of incorporation
- Business incorporate to:
 - Protect assets
 - Save on taxes
 - Legal requirement to perform job
 - Take/accept loan and or investment

Business Types that Incorporate or Form LLCs

WHY INCORPORATE?

- ✓ TAX SAVINGS
- ✓ PARTNERS OR INVESTORS
- ✓ LIQUIDITY
- ✓ TRANSFERABILITY
- ✓ LIMIT LIABILITY
- ✓ LONGEVITY
- ✓ PERSONAL ASSET PROTECTION



Business Formations – Types and Filing Requirements

Business formations come in many different shapes and sizes -
Depending on the client's needs, short & long-term goals.



*Business Entity Types
No Filing Required**

Sole Proprietor

General Partnership

Limited Partnership

**but no liability or asset protection...*



*State/Federal Filing
Required*

C-Corporation

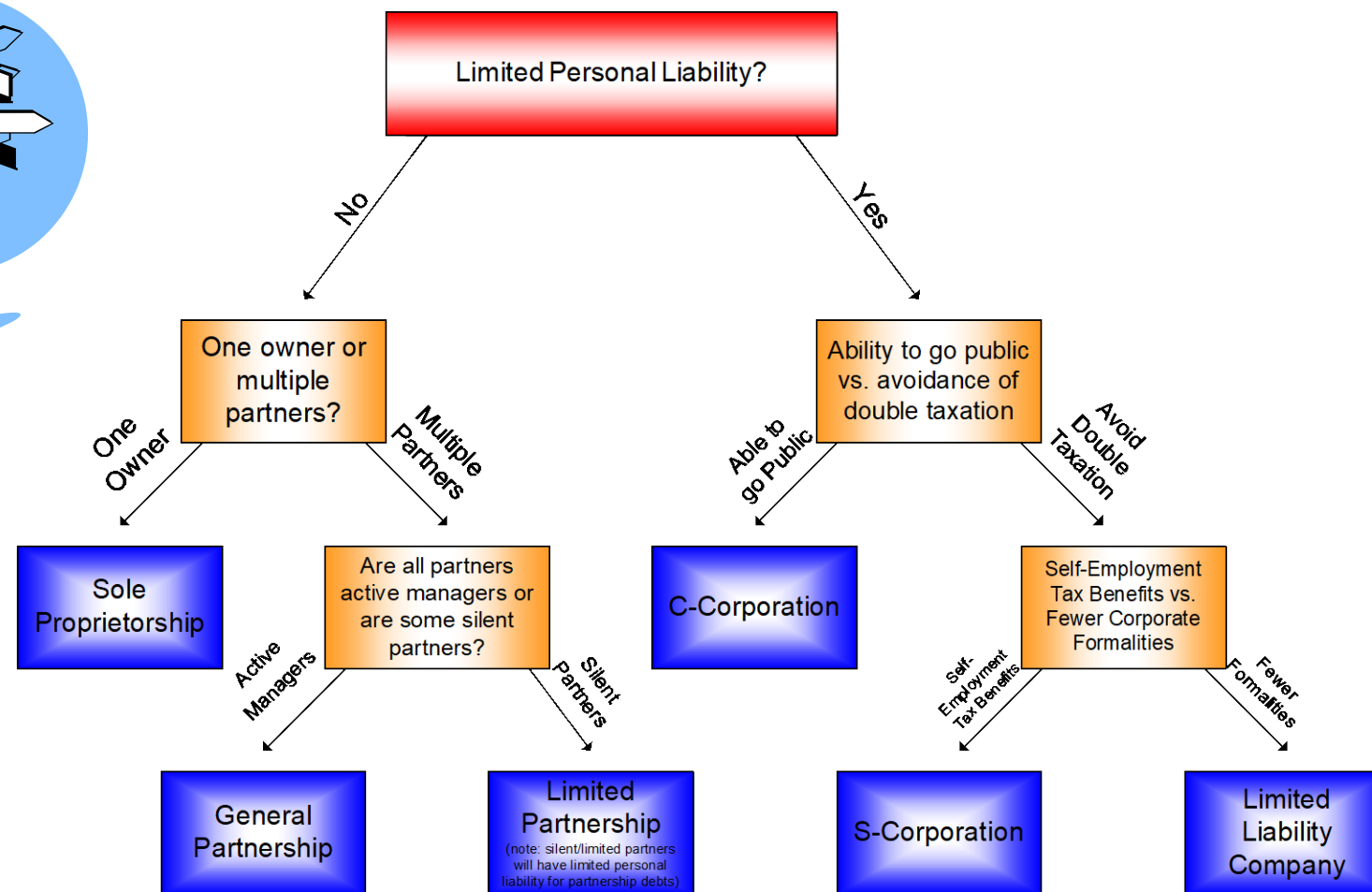
S-Corporation

Limited Liability Company

Professional Corporation

Non-Profit Corporation

Entity Selection Decision Tree



Pros & Cons of a Sole Proprietorship



Pros of Sole Proprietorship:

- Easy Setup & Low Cost
- No Corporate Business Taxes
- No Annual Reports or Filings
- Not Restricted by Formal Business Structure
- Easy Recordkeeping

Cons of Sole Proprietorship:

- Unlimited Personal Liability
- No Ongoing Business Life
- Difficult to Raise Money
- Can't Take on Business Debt
- Unprofessional Perception

General/Business Partnership

Characteristics of Business Type

- Business is operated by two or more people.
- Partnership agreement should be prepared.
- Partners are not considered employees of the company, but self-employed individuals.

Legal Factors/Requirements

- Personal and partnership assets may be at risk.
- Not required to pay separate business income taxes.
- Must file an information return indicating amount of money earned or lost during the year by each partner.
- Each partner is responsible for paying their share of personal income tax. Depending on the business type and location, may be required to obtain business licenses or permits. May be required to file a partnership certificate with a public office.

What Is a Business Partnership?

- A specific kind of legal relationship
- Business partnerships are formed by the agreement between two or more individuals to carry on a business as co-owners
- Types of partnerships and levels of involvement vary



C CORPORATION?

**OR
S CORPORATION?**

LLC?



Similarities Between C & S Corporations



- Both are legal entities
- Both must comply with state requirements
- Both can provide deductible employee benefits
- Both provide limited liability protection for shareholders
- Both require shareholders to pay personal income tax on corp. salaries

C-Corporation

ARTICLES OF INCORPORATION

ARE ALSO CALLED

- ✓ Certificate of Incorporation
- ✓ Business Incorporation Papers
- ✓ Corporate Charter
- ✓ Company Constitution



Characteristics of Business Type

- Considered a separate entity from those who own or operate it.
- Limited personal liability and protection from being personally liable for debts (e.g., bills for supplies/equipments and injuries to persons involved in business activities that are not adequately covered by standard insurance)
- One person may own all the stock
- Has its own name and identity.
- All assets and liabilities belong to the corporation.

Legal Factors/Requirements

- Created under state law (by filing documents with the Secretary of State).
- Tax must be paid on the income made by the corporation.
- If income is distributed to shareholders as dividends, the shareholders must pay tax on amount received as dividends.



S-Corporation

Characteristics of Business Type

- Limited liability and protection from being personally liable for debts.
- Business owners pay income taxes in the same manner as a sole proprietor or a partner.
- Business losses may be offset against other income, which may reduce or eliminate the business owner's tax burden.
- Generally not subject to taxation at the federal level.
 - The advantage of an S corporation is the ability to escape the corporate "double taxation."
- Shareholders are required to pay their share of income tax on the corporation's income, whether or not they received money.

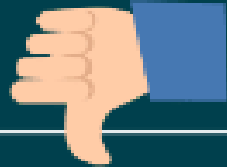
Legal Factors/Requirements

- S-Corporations begin their existence as a C-Corporation at the state level.
- Within the first 75 days from the date of incorporation, IRS Form 2553 to elect S-Corporation treatment must be filed
 - Income of the corporation is only taxed at the individual shareholder level, and not at the corporate level.
- No more than 100 shareholders.
- Ownership is limited to U.S. citizens and resident aliens in the U.S.
 - Cannot be owned by other business entities (i.e. a C-Corporation, S-Corporation, or LLC).
- Not subject to self-employment tax on shareholder's income from the corporation
 - Subject to self-employment taxes on salary paid.

Sole Proprietorship

Total Income = \$75,000

Total Income
x
Self-Employment Tax =
\$75,000 x 15.3% =
\$11,475



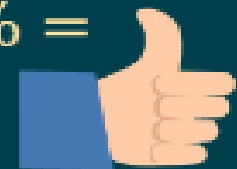
S Corporation

Total Income = \$75,000

Salary = \$37,500

Dividends = \$37,500

Salary
x
Self-Employment Tax =
\$37,500 x 15.3% =
\$5,373.50



LLC



Limited Liability Company

Characteristics of Business Type

- Limited Liability Companies combine the limited liability advantages of corporations with the control and tax advantages of a partnership.
- A Limited Liability Company is more complicated than a normal partnership in its formation.
- Limited Liability owners are generally not liable for the debts and obligations of the LLC.
- Can elect how an LLC will be taxed.



Legal Factors/Requirements

- The entity is taxed like a partnership— income and losses of the LLC are accounted for on the owner's individual tax returns.
- Can be owned by non-U.S. citizens / resident aliens and other business entities
 - one LLC can own some or all of another LLC or C-Corporation).
- Can have unlimited number of members
 - owners of an LLC are known as members
- Less formal than a corporation
 - no minutes, corporate resolutions, or other corporate formalities are required

Federal & State Differences

C Corporation

- Taxed as a separate entity
- Shareholders are not taxed
- Shareholders pay income on payments from the corp.
- Is always recognized by the federal & state



S Corporation

- Avoids double-taxation
- Corp. doesn't pay income taxes
- Can include losses on personal tax returns
- Not recognized in certain states

Ownership & Accounting Differences

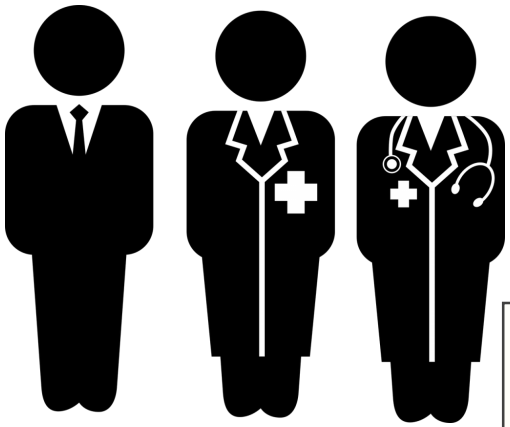
C Corporation

- More tax-free status on fringe benefits
- Can have multiple classes of stock
- Can choose when fiscal year ends
- Bigger corps. required to use accrual accounting method



S Corporation

- Less tax-free benefits for shareholders
- Limited to one class of stock
- Fiscal year must end December 31st
- Only those with inventory have to use accrual accounting method



Professional Corporations & PLLCs

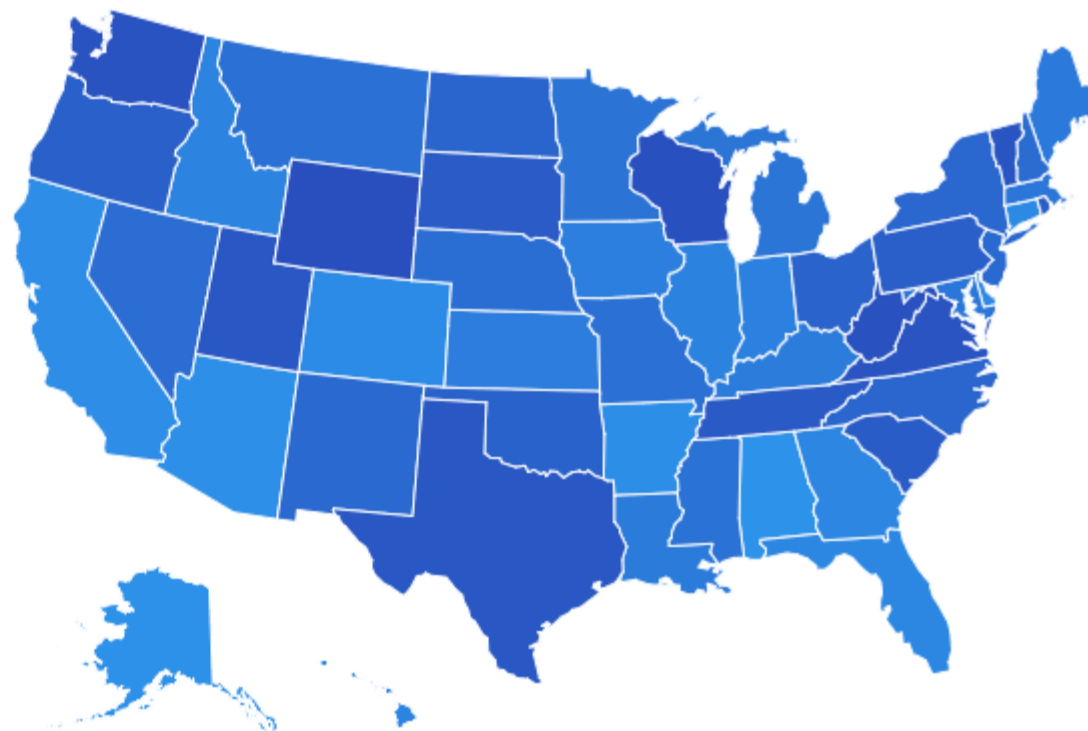
Characteristics of Business Type

- Certain occupations, e.g., physicians, attorneys & accountants, may incorporate their practice through a professional corporation only.
- Some professionals in some states may incorporate as a professional corporation or as a regular corporation.
- All shareholders must be licensed.

Legal Factors/Requirements

- Created under state law (by filing documents with the Secretary of State).
- Limited personal liability and protection from being personally liable for debts of other members.
- Still liable for own malpractice.

What state is the best state to incorporate or form an LLC?



Questions?

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