

How Should Your Business Be Organized?

Given our litigious society, the new tax law, and the continuing discussion about tax reform, it's an important question to examine. The way your business is structured generally affects the extent to which you and any other owners of the business are personally protected from liabilities of the business as well as how your business is taxed.

Nationally, the majority of businesses are organized as sole proprietorships. The share of businesses organized as regular C corporations has declined in recent years, while there has been an increase in hybrid forms of business, including S corporations and limited liability companies (LLCs).

Sole Proprietorship

If you are the only owner, you can operate your business as a sole proprietorship. (It is also possible for spouses to conduct business as a sole proprietorship.) A sole proprietorship offers no liability protection. For federal income-tax purposes, you report your business income and expenses on Schedule C, an attachment to your personal return (Form 1040). Net earnings from the business are subject to self-employment taxes as well as income taxes.

Limited Liability Company

A limited liability company (LLC) is a separate legal entity that can have one or more owners (called "members"). You might prefer an LLC or a corporation over a sole proprietorship if you are concerned about protecting your personal assets in the event your business is sued. An LLC's income is taxed to the owners individually, and earnings are also subject to self-employment taxes.

Corporation

A corporation is a separate legal entity that transacts business, buys equipment, borrows money, etc., in its own name. Although a corporation can be very large and have thousands of shareholders, even a small business with one owner can incorporate. Insulation from personal liability is often a key motivator for forming a corporation.

C corporations. The corporation files its own income-tax returns and uses a

corporate tax rate schedule to figure the taxes due. If corporate earnings are distributed to the shareholders as dividends, that income is taxed a second time to the shareholders, and the corporation receives no tax deduction for the dividend payments. However, as a shareholder working for the company, you generally would take a reasonable salary, which lets you draw out corporate earnings on a tax-deductible basis.

S corporations. Making a valid Subchapter S election for a corporation avoids the potential for double taxation at the federal level. An S corporation files income-tax returns but generally does not pay federal income taxes itself. Instead, the shareholders are taxed individually on their respective shares of the corporation's taxable income. To avoid IRS scrutiny, S corporation shareholders working in the business should draw reasonable salaries and the appropriate employment taxes should be paid on those amounts.

Partnership

A partnership always has more than one owner. Although it is similar to an LLC or an S corporation in certain respects, it must have at least one general partner who is liable for the partnership's debts and obligations. Investors who won't play an active role in the business can receive limited partnership interests. A limited partner's liability risk is limited to the amount invested. Partnerships do not pay federal income taxes; business profits and losses are divided among the partners according to the terms of the partnership agreement and taxed to them individually. A partnership must file an annual informational return with the IRS. ■

Calendar of Filing Dates



MARCH

15 Corporations: Calendar-year corporations file 2012 tax return (Form 1120) and pay any tax due. S corporations file Form 1120S. For an automatic six-month filing extension, file Form 7004 and deposit the estimated tax due.

APRIL

1 Employers: Electronic filers must file 2012 Forms W-2 with the Social Security Administration.

15 Individuals: File 2012 income-tax return (Form 1040, 1040A, or 1040EZ) with the IRS. For an automatic six-month extension, file Form 4868 and deposit the estimated tax due.

15 Individuals: Pay the first installment of 2013 estimated tax with Form 1040-ES.

15 Partnerships: File 2012 calendar-year partnership return (Form 1065). For an automatic five-month extension, file Form 7004.

15 Corporations: Deposit first installment of 2013 estimated tax.

30 Employers: File Form 941, Employer's Quarterly Federal Tax Return; quarterly deposit due.

MAY

10 Employers: Deferred due date for Form 941, if timely deposits were made.

15 Exempt Organizations: File 2012 Form 990, 990-EZ, or 990-N, if the organization reports on a calendar-year basis.

