

Legal Pad

Which form of business is best for me?

BY DARIAN ANDERSEN

Attorney - dband@buslaw.net

The following are excerpts from one of our most requested stories - written by Darian Andersen, a local attorney specializing in business law.

I like to analyze the best business form for a business by looking at the risk of liability to the business owner and the tax consequences. Three basic questions are the starting point of the analysis: 1. What is the risk of personal liability to the owner(s) from the business—Does the business have a strong possibility of hurting someone by accidents or by other means? 2. Does the business have employees, other than the owner(s)? 3. What are the tax consequences (is there a way to save money on taxes by selection of a different form of business? The trick is to look at the missiles of risk headed toward you and your business.

Sole proprietorship. This form of business is the easiest to form. You just start business. It is owned by a single person (or a husband-wife combination that do joint tax reporting). The business may select a name other than the owners' by filing a fictitious name statement with the county real property

records, with a less than \$10 recording fee. The business is shown as a schedule C on the owner(s) form 1040 tax return. It buys, sells and/or services in the name of the owner(s) doing business in their name(s) or as its fictitious or trade name. The owners are liable for whatever consequence arise, which may be covered by insurance.

Partnership. This form of business is similar to the sole proprietorship as far as liability of the owners for the consequences of doing business. The entity involves two or more persons doing business together and there may be but need not be a partnership agreement. It has the additional negative effect of one partner being liable for the other partner's business actions. It is taxed by filing its own tax return and by providing its owners with a report called a K-1 showing each of the partners' income or loss for the year which is then added to the owners' tax returns on Form 1040. There no limited liability protection arising from the form of business.

S Corporation. An S corporation is formed the same way as a C corporation, by filing a Certificate of Incorporation with the Secretary of State, but its stockholders make an election filed with the Internal Revenue Service to be taxed as a partnership. Its

ownership is shown by issuing stock to its owner or owners. Its stockholders or owners are not held liable for the actions of the business but claimants may only claim against the assets of the corporation. It is a great supplement to insurance to protect its owner(s) from personal liability for the actions of the business. As with a partnership, it must file a tax return, but it pays no taxes and its owner(s) get K-1 reports at the end of the year to include in their tax returns. Its key distinctive features include limited liability for the stockholders, easy transferability of ownership (by transferring stock) and taxation as a partnership.

C Corporation. A C corporation must file its own tax return and pay taxes on its income. Dividends may be paid to stockholders but come out of the company only after it pays taxes. It has much greater capability of utilizing employee benefits on a tax deductible basis. Its owner(s) may be employees, and their income comes out prior to taxation of the corporate income. Its key distinctive features include limited liability for the stockholders, easy transferability of ownership (by transferring stock) and taxation as a corporation. This is the form of business normally used if there will be a large number of stockholders, there is an intention to become a public company by selling stock to people other than the founding stockholders, or if there is enough revenue to use significant deferred income (retirement plans) and employee benefits.

Limited Liability Company. This relative new-comer to the options for forms of doing business has the benefits of an S corporation—limited liability of stockholders (but they are called members), taxation as a partnership, but with a lot less formality. A corporation must hold an annual meeting of stockholders (to elect directors)

and of directors (to elect officers and approve significant expenditures) and must keep annual minutes in order to avoid having its corporate veil pierced, which means the stockholders become personally liable for the obligations of the corporation. A limited liability company should still hold annual meetings and minutes but the requirement is less formal. Until recently, a limited liability company did not have to file annual reports with the Oklahoma Tax Commission like the franchise tax return required of a corporation. Its key features include taxation as a partnership with a limitation of liability to its owners, but with less formality than a corporation.

Conversions of Business Entities to Limited Liability Companies. On November 1, 2001, Oklahoma adopted entity conversion statutes (18 OS 2054.1 and 2041.2) that enable a corporation, a partnership or other business entity (not including a sole proprietorship) to convert its business form to a limited liability company. The statute also allows conversion from a limited liability company into another entity. If you determine you are in the wrong form of business, then you can convert it to the form that is best for you. This new statute simplifies and reduces the cost of changing the entity form, which previously required a merger or dissolution, to a simple filing of Articles of Conversion and Articles of Organization for the entity with the Secretary of State. Good work, Legislature, a real plus for business owners!

Darian can be reached at his Edmond office, 405-330-2235 or you can reach him via e-mail at dband@buslaw.net.



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