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Company Growth and Business Structures

LEARNING OBJECTIVES

- Distinguish between informal and formal business structures
- Explain the importance of liability being matched to the business endeavor
- Recognize the tax implications of informal and formal business structures
- Discuss how to establish an LLC and a corporation

Case Study: Is Cone Crazy a Sole Proprietorship?



Willa knows that if a lawsuit exceeds her insurance policy, her private assets (car, personal savings account, furniture, and more) could be used to cover the shortfall.

It's time to learn about sole proprietorships vs. formal business structures.

Business Structures: Options for Entrepreneurs

Sole proprietorship

- An informal business structure
- No legal filings required in state of operations
- Taxes are filed on personal tax return
 - Schedule C
- May obtain an EIN if desired
- No liability protection

SCHEDULE C (Form 1040)		Profit or Loss From Business (Sole Proprietorship)		OMB No. 1545-0047
Department of the Treasury Internal Revenue Service		Attach to Form 1040, 1040-SR, 1040-SS, 1040-NR, or 1041; partnerships must generally file Form 1065. Go to www.irs.gov/ScheduleC for instructions and the latest information.		2024 Attachment Sequence #
Name of proprietor			Social security number	
A Principal business or profession, including product or service (see instructions)			B Enter code from instructions	
C Business name. If no separate business name, leave blank.			D Employer ID number (EIN)	
E Business address (including suite or room no.) City, town or post office, state, and ZIP code				
F Accounting method: (1) <input type="checkbox"/> Cash (2) <input type="checkbox"/> Accrual (3) <input type="checkbox"/> Other (specify) _____				
G Did you "materially participate" in the operation of this business during 2023? If "No," see instructions for limit on losses <input type="checkbox"/> Yes <input type="checkbox"/> No				
H If you started or acquired this business during 2023, check here <input type="checkbox"/> Yes <input type="checkbox"/> No				
I Did you make any payments in 2023 that would require you to file Form(s) 1099? See instructions <input type="checkbox"/> Yes <input type="checkbox"/> No				
J If "Yes," did you or will you file required Form(s) 1099? <input type="checkbox"/> Yes <input type="checkbox"/> No				
Part I Income				
1 Gross receipts or sales. See instructions for line 1 and check the box if this income was reported to you on Form W-2 and the "Statutory employee" box on that form was checked <input type="checkbox"/>				
2 Returns and allowances				
3 Subtract line 2 from line 1				
4 Cost of goods sold (from line 42)				
5 Gross profit. Subtract line 4 from line 3				
6 Other income, including federal and state gasoline or fuel tax credit or refund (see instructions)				
7 Gross income. Add lines 5 and 6				
Part II Expenses. Enter expenses for business use of your home only on line 30.				
8 Advertising				
9 Car and truck expenses (see instructions)				
10 Commissions and fees				
11 Contract labor (see instructions)				
12 Depletion				
13 Depreciation and section 179 expense deduction (not included in Part III) (see instructions)				
14 Employee benefit programs (other than on line 19)				
15 Insurance (other than health)				
16 Interest (see instructions): a Mortgage (paid to banks, etc.) b Other				
18 Office expense (see instructions)				
19 Pension and profit-sharing plans				
20 Rent or lease (see instructions): a Vehicles, machinery, and equipment b Other business property				
21 Repairs and maintenance				
22 Supplies (not included in Part III)				
23 Taxes and licenses				
24 Travel and meals: a Travel b Deductible meals (see instructions)				
25 Utilities				
26 Wages (less employment credits)				
27a Other expenses (from line 48)				

Business Structures: Options for Entrepreneurs (cont.)

Partnership

- Informal business structure
- Startup is similar to that for sole proprietorship
- Taxes filed on personal tax return
 - Form 1065
- Profits and liability are split per partnership terms


Form 1065		U.S. Return of Partnership Income		OMB No. 1545-0047
Department of the Treasury Internal Revenue Service		For calendar year 2023, or tax year beginning _____, 2023, ending _____, 20____.		2023
		Go to www.irs.gov/Form1065 for instructions and the latest information.		
A Principal business activity	Type or Print	Name of partnership	D Employer identification number	
B Principal product or service		Number, street, and room or suite no. If a P.O. box, see instructions.	E Date business began	
C Business code number		City or town, state or province, country, and ZIP or foreign postal code	F Total assets (see instructions)	
			\$	
G Check applicable boxes: (1) <input type="checkbox"/> Initial return (2) <input type="checkbox"/> Final return (3) <input type="checkbox"/> Name change (4) <input type="checkbox"/> Address change (5) <input type="checkbox"/> Amendment				
H Check accounting method: (1) <input type="checkbox"/> Cash (2) <input type="checkbox"/> Accrual (3) <input type="checkbox"/> Other (specify): _____				
I Number of Schedules K-1. Attach one for each person who was a partner at any time during the tax year: _____				
J Check if Schedules C and M-3 are attached: _____				
K Check if partnership: (1) <input type="checkbox"/> Aggregated activities for section 465 at-risk purposes (2) <input type="checkbox"/> Grouped activities for section 469 passive activity				

Caution: Include only trade or business income and expenses on lines 1a through 22 below. See instructions for more information.

Business Structures: Options for Entrepreneurs (cont.)

Limited Liability Company (LLC)

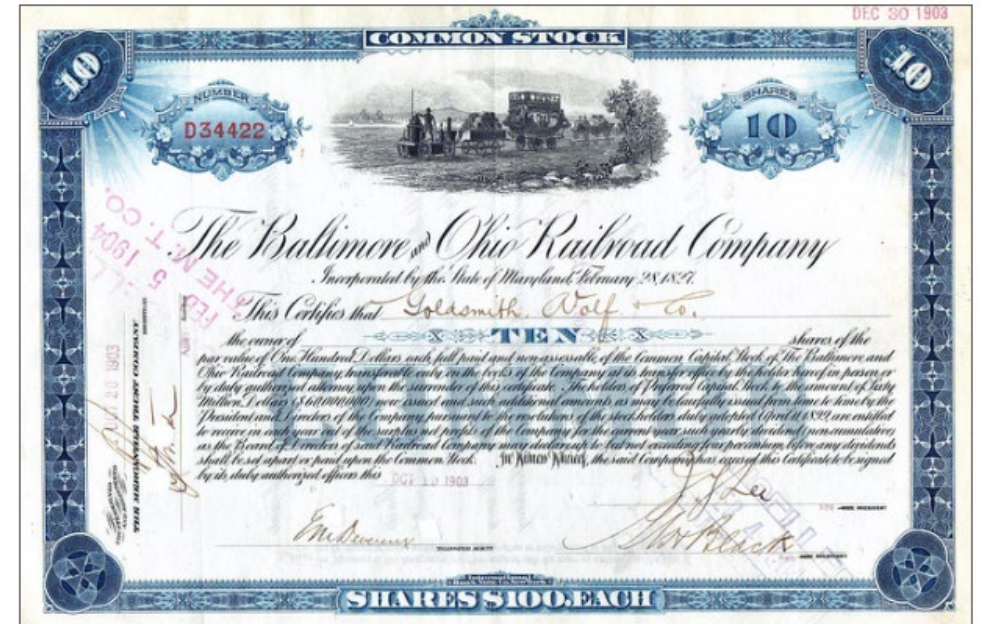
- Formal business structure
- Liability is limited to company's assets
- Required documentation
 - Articles of organization
 - Operating agreement
- Tax-filing options:
 - Sole proprietorship
 - Partnership
 - Corporation

ARTICLES OF ORGANIZATION LIMITED LIABILITY COMPANY (95-4270) Page 1 of 1	
	<p>Business Services Division Tre Hargett, Secretary of State State of Tennessee 312 Ross L. Parks AVE, 6th FL Nashville, TN 37243-1102 (615) 741-2286</p> <p>Filing Fee: \$50.00 per member (minimum fee = \$300, maximum fee = \$3,000)</p>
<p><i>For Office Use Only</i></p>	
<p>The Articles of Organization presented herein are adopted in accordance with the provisions of the Tennessee Revised Limited Liability Company Act.</p>	
<p>1. The name of the Limited Liability Company is: _____</p> <p>(NOTE: Pursuant to the provisions of T.C.A. §48-249-106, each Limited Liability Company name must contain the words "Limited Liability Company" or the abbreviation "LLC" or "L.L.C.")</p>	
<p>2. Name Consent: (Written Consent for Use of Indistinguishable Name)</p> <p><input type="checkbox"/> This entity name already exists in Tennessee and has received name consent from the existing entity.</p>	
<p>3. This company has the additional designation of: _____</p>	
<p>4. The name and complete address of the Limited Liability Company's initial registered agent and office located in the state of Tennessee is:</p> <p>Name: _____</p> <p>Address: _____</p> <p>City: _____ State: _____ Zip Code: _____ County: _____</p>	
<p>5. Fiscal Year Close Month: _____</p>	

Business Structures: Options for Entrepreneurs (cont.)

Corporation

- Formal business structure
- Limits liability to company assets
- Taxed on corporate earnings and dividends paid on those earnings
- Can raise capital via sale of pieces of ownership called *stock*
- Run by shareholders who elect board members



Managing Liability Through the Business Structure

- Liabilities are related to:
 - Suppliers
 - Credit payments
 - Wages
 - Taxes
 - Asset management
- How to deal with liability depends on the business's structure
- Types of liability

Current Liabilities

- Must be paid within the year

Noncurrent Liabilities

- Can be paid after one year or one operating cycle

Contingent Liabilities

- Depend on the outcome of an event

Business Assets

- Company holdings required for normal operations

Business Structures Based on Business Needs

BUSINESS STRUCTURES BASED ON BUSINESS NEEDS			
	Ownership	Liability	Taxes
Sole Proprietorship	1 owner	Personal and business assets	On the owner's personal tax return
Partnership	2+ owners	Personal and business assets (unless a limited partnership)	On each owner's personal tax return
LLC	1+ owners	Business assets only	On each owner's personal tax return or using a separate EIN (corporate tax) tax return
Corporation	1+ stock-holders	Business assets only	On the corporation's tax return
Cooperatives	Owned by members	Generally business assets only	Members taxed on the yearly dividends received

Business Taxes: File on Personal or Business Return?

Sole proprietorship

- Requires an EIN for employee payroll tax filings
- A pass-through entity
 - Earnings of the company are “passed through” to the owner
- Sole proprietor pays 100% of self-employment tax
 - FUTA and FICA (Social Security and Medicare)

Business Taxes: File on Personal or Business Return? (cont.)

Limited liability company

- Requires an EIN if more than one person is in the LLC
- Can deduct salary from LLC earnings if filing as a corporation
- Can elect to be a pass-through entity

Business Taxes: File on Personal or Business Return? (cont.)

Corporation

- Has an EIN due to its separate entity status
- No pass-through taxation
- Deducts salaries from corporate earnings

Setting Up an LLC and a Corporation

LLC process:

1. Select a name.
2. Choose a registered agent (often the secretary of state).
3. File articles of organization.
Rules and responsibilities for how the LLC will be run
4. Create an operating agreement.
5. Obtain an EIN.

Setting Up an LLC and a Corporation (cont.)

LLC articles of organization

- Specifies name/location
- Designates registered agent
- Identifies period of operation
- Stipulates whether
 - Member managed
 - Manager managed
 - Director managed

Form LLC-5.5 February 2022	Illinois Limited Liability Company Act Articles of Organization	FILE # This space for use by Secretary of State.
Secretary of State Department of Business Services Limited Liability Division 501 S. Second St., Rm. 351 Springfield, IL 62756 217-524-8008 ilsos.gov	SUBMIT IN DUPLICATE Type or print clearly.	
Payment must be made by certified check, cashier's check, Illinois attorney's check, C.P.A.'s check or money order payable to Secretary of State.	Filing Fee: \$150 Approved:	

1. Limited Liability Company name (see Note 1):			
2. Address of principal place of business where records of the company will be kept: (P.O. Box alone or c/o is unacceptable.)			
3. Articles of Organization effective on: (check one) <input type="checkbox"/> the filing date <input type="checkbox"/> a later date (not to exceed 60 days after the filing date):			
Month, Day, Year			
4. Registered agent's name and registered office address:			
Registered agent: (P.O. Box alone or c/o is unacceptable.)			
First Name	Middle Initial	Last Name	
Registered office:			
Number	Street	Suite #	
City		IL	ZIP
Note: The registered agent must reside in Illinois. If the agent is a business entity, it must be authorized to act as agent in this state.			
5. Purpose(s) for which the Limited Liability Company is organized: (see Note 2)			

Setting Up an LLC and a Corporation (cont.)

LLC operating agreement

- Specifies name/location
- Specifies all members
- Specifies rules and policies for the LLC and its members

**LIMITED LIABILITY COMPANY OPERATING
AGREEMENT**

OF

[COMPANY NAME] LLC (the "Company")

Formed in the state of _____

This LLC Operating Agreement (hereinafter known as the "Agreement") is a MULTI-MEMBER LLC OPERATING AGREEMENT, entered into by and between:

- [MEMBER 1], of [Address],
- [MEMBER 2], of [Address],
- [MEMBER 3], of [Address],
- [MEMBER 4], of [Address].

Hereinafter each will be known as a "Member" and collectively known as the "Members."

WHEREAS the Member(s) wish to set up a limited liability company under the laws of the State of [STATE] and set forth the terms of the Company's operation and the relationship between Member(s) within this agreement.

NOW, THEREFORE, the Member(s) and the Company, collectively known as the "Parties," agree as follows:

I. Introduction

1. Name and principal place of business: The name of the company shall be _____ and its principal place of business shall be at _____ or any other place of business as determined by the Member(s).

2. Formation: On [MM/DD/YYYY], the Company was formed when the Member(s) filed the Articles of Organization with the Secretary of State in accordance with the statutes governing limited liability companies in the State of [STATE].

Setting Up an LLC and a Corporation (cont.)

Corporation requirements

- Issue stock
- Be named
 - Include *Corporation/Corp.* or *Incorporated/Inc.*
- Select a registered agent
- Be incorporated
 - By an individual over the age of 18
- Create articles of incorporation
- Create bylaws

REQUIREMENTS FOR THE **ARTICLES OF INCORPORATION**

- 1 Name of corporation**
- 2 Name/address of the registered agent**
- 3 Type of corporation**
Professional, C corp, profit, nonprofit
- 4 Names/addresses of the board of directors**
- 5 Number of shares issued**
- 6 Duration of the corporation**
Corporations can exist after the founders have left!
- 7 Name/address of the incorporator**
The one setting up the corporation

CHAPTER SUMMARY

- Formal (legal) and informal business entities have different rules and requirements.
- Considering risk and liability is critical when choosing the business structure.
- Considering tax compliance is critical when choosing the business structure.
- There are requirements for establishing LLCs and corporations that can include obtaining an EIN, filing documentation, or issuing stock.