**Choosing the Right Legal Entity**

**By Julie Heyroth Gasper, SCORE Counselor**

When counseling my clients on what type of legal entity they should choose, I recommend that they consider these five criteria:

• Liability protection
• Complexity of the organization and cost
• Future capital raises
• Taxation
• Exit strategy

A sole proprietorship offers no liability protection, so though this is the simplest way to do business because the only "entity" involved is you, it also puts all of your personal assets at risk. I think it is beneficial to form a new legal entity, even in the simplest businesses.

**Cost to incorporate and ongoing costs to maintain corporation**

LLC’s are cheaper, faster, and easier to create than S or C corporations. The difference is in the range of a few hundred dollars to a couple of thousand dollars. This is due primarily to legal fees and the complexity of the incorporation documents. Also, these costs are not deductible as expenses on your tax return in the year you pay them – they need to be capitalized and then amortized over at least 3 years. So, it takes years to get the tax write-off for these costs.

Future capital raises. It is easier to sell stock and raise additional funding, if you don’t want or can’t get debt. So, stock corporations are favored if you plan on needing a lot more money.

**Taxation**

 The profits from an LLC are taxed once – on your personal tax returns as ordinary income at your individual tax rate. The profits from an S or C corp are taxed first when you file the corporate tax return, roughly at a rate of 35% (this is the federal rate, state tax is additional), and then when the corporation pays out dividends. The dividends are taxed as ordinary income (depending on your tax bracket, this ranges from roughly 10% for federal and state taxes up to 43% for taxable incomes over $350,000. Beware the fiscal cliff - this is probably going to change.) Obviously, many small business owners prefer to be taxed only once! On an S corp, you do have the choice to elect to be taxed as a partnership (that would then be only once, not twice) when you form the corporation. You can change that election later. But once you change it, you can’t go back to being taxed as a partnership.

**What is your exit strategy from the business?**

In other words, do you want to own it “forever,” do you want to grow it and sell it?, etc. Owning it yourself would lean toward an LLC. If you want to sell it, an S Corp or C Corp (because they are companies that can sell stock), are more popular because it is easier to sell the stock in the company.

**Final thoughts**

I also recommend the "Guide to Starting a Small Business in Minnesota," (link below). Starting on page 1, they have a nice review of choices of legal entities and the consequences of that choice that goes more in depth than my summary above.

<http://www.positivelyminnesota.com/Data_Publications/Publications/Business_Guidebooks/Guide_to_Starting_a_Business_in_Minnesota.aspx>

Your decision on type of legal entity is not carved in stone! Businesses do change the type of entity they are, it just costs more money. So, do not look at this decision as irrevocable, if you choose LLC now, and in the future want to incorporate as an S or C corp. that is very doable and not an uncommon occurrence.

**Choosing A Tax Accountant**

**By Julie Heyroth Gasper, SCORE Counselor**

**Q:** I have a new client that asked me how to "shop" for a good accountant to do their taxes. The client formed an LLC and started a general contracting business last year and did pretty well. One has some other interests, including a farm and rental properties. He had worked with an accountant last year, but had nothing to compare. He also asked if he could just use TurboTax for Business and do it himself. I'm reluctant to encourage that approach without knowing more.

**A:** I always recommend that clients go to [www.mncpa.org](http://www.mncpa.org) (the website for the Minnesota Society of CPA's) and click on "Find a CPA." I recommend they select three firms and interview them to see if there is a fit. Each client is going to "click" with a different person and have different needs, and every firm is going to have different specialties, location, etc., so I never recommend any one I know. Obviously, I do recommend a CPA rather than just a tax preparer. It is more expensive, but you get what you pay for!

If it looks like they want to do it themselves, I try to make a judgment based on their skills to see if they can give TurboTax or a similar product a try. TurboTax for Business is about $130, so this is not going to be "cheap" either. If they are a sole proprietorship or single member LLC and will file a Schedule C, then all they need is TurboTax Deluxe ($80) for their Form 1040. If they are a multi-member LLC, partnership, S-Corp, or C Corp., then they will need both TT for Business and TT Deluxe to file their 1040. So, that's a total of $210 already. Then I start talking about the differences between book and taxable income, tax depreciation, etc. It's about at this point in time that the client's eyes roll back in their heads and the $500 or so that they will pay to have their tax return done for them doesn't look so bad................

In other words, I'll help clients if they want to do it themselves, but I really stress the complexity of tax law, how it is constantly changing, etc. that I am NOT A TAX EXPERT and that they probably should go to a professional.

Finally, I think the attached article is a great list of questions that an entrepreneur should ask when they are interviewing CPA's/tax preparers. I'll be giving this to my clients when I recommend that they use "Find a CPA" on the MNCPA website. Maybe your client would get some value out of it, too.