

## Corporation Compared to LLC

The Limited Liability Company (LLC) is often a better choice for a business structure than either the C-Corporation or S-Corporation. The LLC is taxed like a partnership or S-Corp., with flow-through taxation, and provides the same degree of protection from personal liability that is provided by both types of corporations, and is far easier to operate, without the requirement to observe the bothersome corporate formalities associated with both types of corporation.

Both the C-Corp. and the S-Corp. have a complicated three-tier management structure, which requires the observance of certain corporate formalities in order to obtain the protection from personal liability that the corporation is intended to provide. For example, the owners of a corporation are called shareholders, which means they must be issued stock certificates, which are then recorded in a stock transfer register. The shareholders must meet once each year to elect or appoint directors. The directors manage the company for the shareholders, who own it. The directors must meet annually to elect or appoint officers, who run the company for the directors, who manage the company for the shareholders, who own it. Officers must include as a minimum, a president, a secretary and a treasurer. All of these appointments must be carefully documented and properly recorded each year in the corporate Minute Book. Otherwise, you risk losing protection from personal liability, which a shareholder should receive.

It is possible to have a one-person corporation, with one person being the sole shareholder, the sole director and all three officers. However all of the corporate formalities listed above must still be observed every year. Otherwise, the corporation could be considered to be the alter ego of the shareholder, and limited personal liability protection could be lost.

To help in observing all of the requisite corporate formalities, vendors of legal supplies offer something called a Corporate Kit. A Corporate Kit typically includes a Minute Book, in which to record corporate actions, a corporate seal to affix to official documents, printed stock certificates, and may even include a set of Bylaws. One source for Corporate Kits, among many other suppliers, can be found on the Internet at [www.corporatekits.com](http://www.corporatekits.com). Another vendor is at [www.fastkit.com](http://www.fastkit.com).

### Limited Liability Company (LLC)

An attractive alternative to forming a corporation is the LLC. The main reason most people form corporations is to obtain the protection of having limited personal liability for claims made against the company and/or its business. The LLC provides exactly the same degree of protection from personal liability that a corporation does, without the necessity of observing the cumbersome corporate formalities referred to above. In fact, the LLC may even provide greater liability

protection than a corporation. In certain circumstances, a creditor in a lawsuit against a shareholder may be able to acquire his shares of stock in the corporation. Then, he can vote the shares of stock with adverse consequences, even forcing the dissolution of the corporation. Since a LLC does not issue stock, this risk of losing control of the company does not exist with a LLC. One disadvantage that the LLC presents when compared to a corporation is that the owners of an LLC, called Members, may have to pay self-employment tax on money paid to them by the LLC. Be sure to consult with a CPA about this when choosing a legal business structure. This tax disadvantage does not apply to a corporation. Otherwise, the simplified management structure of a LLC makes it a viable alternative to forming a corporation.

Just as there can be a one-person corporation, there can also be a single-member LLC. A LLC with more than one member is taxed by the IRS like a partnership or S-Corp. with flow-through taxation. The LLC itself does not pay taxes; only the members do. A single member LLC is taxed like a sole proprietorship, with taxes being paid on Schedule C of the owner's 1040 personal income tax return.

The LLC provides the same degree of protection from personal liability that both types of corporations do, without the need to observe any of these complicated corporate formalities. For that reason, the LLC is often a better choice of business structure than either the C-Corp. or S-Corp.

Whenever there are more than one owner of a business, it is important to have a written agreement spelling out the relationship among them, their respective rights, duties and responsibilities. Besides specifying how profits will be shared and/or how losses will be allocated, this written agreement should include a Buy/Sell provision that specifies that if one partner loses interest in the business (or dies), and wants to sell his/her share to somebody else, it must first be offered to the other owners. This prevents you from suddenly having a stranger as your business partner.

Included below is a checklist for writing such a LLC Operating agreement. Because of its complexity and importance, such an agreement should be prepared by a lawyer. In a LLC having more than one member, a written operating agreement should cover the following topics as a minimum:

- The identity of the members;
- The business to be conducted;
- The name to be used for the enterprise;
- The contributions, both initial and future, to be made by each member and how they will be valued (i.e. capital);
- The percentage interest of each member in the LLC, and distributions and allocations of profits and losses;
- Management, whether by members or a manager, including any salaries or draws paid to members, and the keeping of books and accounts;

- Any authorized borrowings;
- How any new members will be admitted;
- In 50/50 ownership, a tie-breaking mechanism to avoid deadlock;
- Assignment of membership interests, including upon death of a member, and payments to withdrawing or deceased members;
- Procedure for buying out a member's interest (Buy/Sell agreement);
- Dissolution and termination of the LLC;
- Any desired dispute resolution mechanisms (e.g. mediation or arbitration) in lieu of litigation between members;
- Requirements to amend the operating agreement.