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## Ask SCORE

### HOW THE BUSINESS STRUCTURE YOU SELECT AFFECTS YOUR INCOME TAX TREATMENT

The business structure you choose for your startup will affect your company from a legal standpoint, and it will have an impact on your taxes, as well. Before you decide on the structure for your small business, you should do some research and talk to tax and legal professionals for guidance. The better you understand your options, the more likely you'll be to operate under the structure that will benefit your business the most.

#### An Overview of A Few of the Most Common Business Structures

**Sole Proprietorship:** By default, businesses are considered sole proprietorships (partnerships if more than one owner) if their owners don't register them formally as independent entities. Many at-home businesses start this way because sole proprietorships require the least amount of registration paperwork and ongoing compliance efforts. From an income tax perspective, a sole proprietorship is also considered one in the same as its owner. Your business profits and losses flow through to your personal income tax return.

(Note that with a sole proprietorship, your personal assets are not separated from those of your business. This poses some

risks. Your home, bank accounts, retirement savings, and other personal belongings might be in jeopardy if someone were to sue your company. When you form a Limited Liability Company [LLC] or incorporate your business, however, your personal assets receive some protection from legal action brought against your business. Be aware liability protection and tax treatment may vary depending on the state where a business is incorporated matters, so it's important to talk with an attorney and tax professional.)

**Limited Liability Company (LLC):** You can form an LLC as either a single-member (single owner) or multi-member (multiple owners). This legal structure provides the limited liability advantages

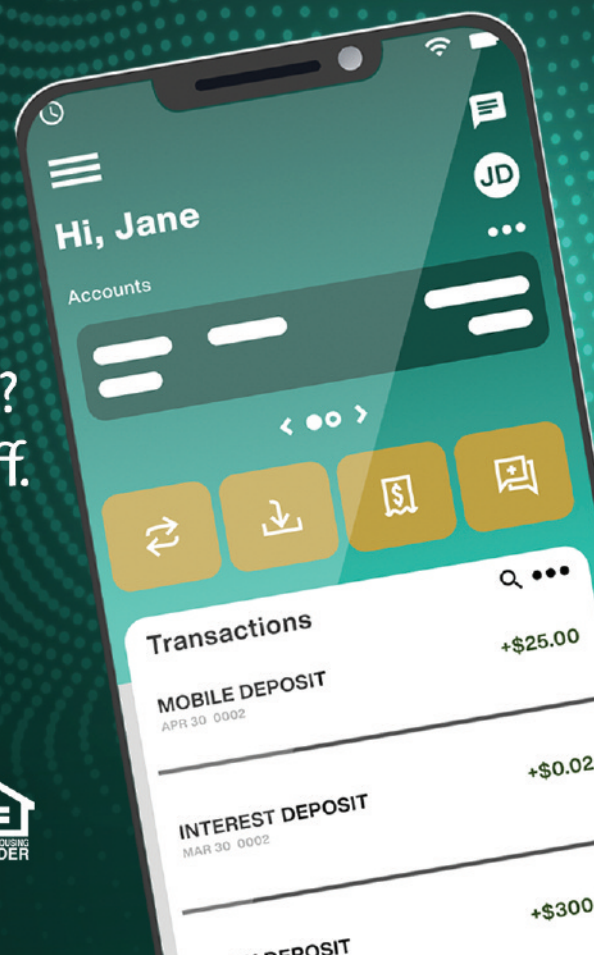
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of a corporation and the flexibility of a sole proprietorship. As with sole proprietorships/partnerships, an LLC's profits and losses flow through to owners' personal income tax returns. In addition, LLCs offer some tax flexibility; you can elect to have your LLC taxed as an S Corporation or a C Corporation.

**S Corporation:** The S Corporation structure has gained the favor of many small business owners because it offers one level of tax at the shareholder level and some relief from the self-employment tax burden on owners. Only an owner's reasonable wages/salaries are subject to self-employment (FICA) tax, and profit distributions to shareholders flow through to the individual shareholders' income tax returns.

**C Corporation:** C Corporations offer more extensive personal liability protection and growth potential than other structures, and the way income taxes are applied differentiates this structure, too. With a C Corp, income is taxed at the corporate tax rate when your business earns it. Profits are then taxed again at the personal income tax rates when shareholders' distributions are made.

**Partnerships:** Another important type of business structure, partnerships come in different legal forms, including corporations, limit liability, and manage-

rial control. Tax treatment and personal liability protection vary depending on the type of partnership you form and the state in which you incorporate.

## Get the Right Help to Make the Right Choice

The information we've provided here is meant to share some of the basics you should know when deciding on the business structure for your small business. It is not intended as professional legal or accounting advice. Carefully consider your type of business and long-term plans when determining the best legal structure for your business. We also recommend you consult a reputable attorney and business tax expert for insight and guidance. If you need help finding trustworthy professionals in your area, make an appointment to meet with a SCORE TriCounty mentor at <https://tricounty.score.org/content/find-mentor-183>.

Since 1964, SCORE "Mentors to America's Small Business" has helped more than 10 million aspiring entrepreneurs and small business owners through mentoring and business workshops. More than 11,000 volunteer business mentors in over 320 chapters serve their communities through entrepreneur education dedicated to the formation, growth and success of small businesses. For more information about starting or operating a small business, contact SCORE TriCounty. You can call 610.327.2673, email [tricity@scorevolunteer.org](mailto:tricity@scorevolunteer.org) or visit the website at [www.tricity.score.org](http://www.tricity.score.org).



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