SHOULD I FORM AN ENTITY FOR MY BUSINESS?

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Whether you are starting a new business or operating an existing enterprise, you should consider the legal form of your business and the need to protect your personal assets from business liabilities. In New Jersey, businesses commonly are corporations, limited liability companies, general or limited partnerships or sole proprietorships. Which entity you should choose depends largely upon the type of business you are in and other important factors. The following is a brief summary of key legal issues with each type of entity for you to consider:

Sole Proprietorship

When you conduct business on your own without another owner and without forming a separate legal entity, you are doing business as a sole proprietorship. Your personal taxable income includes the profits of the business. If you use a name other than your personal name, you must file a trade name certificate with the clerk of the county in which you do business. You are personally liable for all debts (including taxes and lawsuits) of your business, and creditors of the business can reach all of your personal assets.

Partnership

Where more than one person owns a business without forming a separate legal entity, they are considered partners and the business is a partnership. While it is simple, a partnership offers no protection against liability. In addition, the law provides many rights and obligations among the partners. Many people clarify the effect of partnership law by having their own partnership agreements to deal with control of business operations, sale of the business, allocation of profits and similar matters. A partnership has no taxpayer identification number, and each partner reports his or her portion of the income on his or her personal tax returns. Like a sole proprietorship, a partnership must file a trade name certificate. Each partner has unlimited personal liability for the debts and lawsuits of the partnership, and creditors can reach each partner's personal assets. One important concern is that if one partner signs a contract or takes action on behalf of the partnership, the other partners could be liable as if they had signed it or had personally taken the action themselves.

Limited Partnership

This type of entity provides limited liability for partners who are merely investors and are not involved with the operation of the business. Limited partnerships are commonly used for real estate investments and are not appropriate for businesses in which all owners are actively involved.

Corporation

Corporations have existed for many years and provide owners/investors with strong protection against personal liability. Only in special circumstances can the creditors of the corporation "pierce the corporate veil" to reach the personal assets of a shareholder. A corporation is a separate legal entity and a legal "person" that can make contracts, sue and be sued. It is formed by filing a certificate of incorporation with the state government and is governed by a board of directors and a set of bylaws. Where there are multiple owners, a shareholder's agreement governing buyouts and sales of the business is appropriate. A traditional corporation (or "C-corporation") pays corporate tax on its earnings and any profits paid to shareholders are then taxed again as dividends. While corporations can avoid such "double taxation" by paying profit to their shareholders as compensation, there are limits on the amounts that can be paid, so a C-Corporation is not appropriate for all types of business. Another way around "double taxation" is to make an "S election" that designates the corporation as an "S-Corporation" whose profits are taxed only at the shareholder level. S-Corporations have additional limitations that must be met, such as the number and type of shareholders. Some states (including New Jersey) do not recognize the S-Corporation for State tax purposes.

Limited Liability Company

A business owner can form a limited liability company ("LLC"), which can be thought of as a hybrid between a partnership and a corporation. The LLC operates much like a partnership in that its income is taxed at the owners' level, but it also has protections against liability similar to those of a corporation. A person choosing this type of entity files a certificate of formation with the State, obtains a taxpayer identification number, and signs an operating agreement. The flexibility of ownership, pass through tax treatment and protection from liability make the LLC a favored choice for most businesses.

This overview lists some of the options available to business owners to save taxes and shield personal assets from business liability. Your personal situation will influence your decisions and you should seek legal advice before proceeding. At Wilentz, Goldman & Spitzer, P.A., our corporate attorneys can work with you to identify your goals, choose an entity and form it in a cost effective, timely manner and often for a flat fee. It is our goal to see you succeed and to earn a long-term relationship with you.

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