



NATIONS
BUSINESS & TAX CENTERS INC

BUSINESS PLANNING GUIDE

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At Nations Business Center, Inc. we strive to assist our clients in dealing with every aspect of business and financial challenges. We take pride in offering our clients an array of business products and services that are affordable.

We have put together this Business Planning Guide in an effort to assist those of you interested in forming business entities. The guide is meant as an overview, about the different types of entities you can choose from. Your objective in choosing an entity should be the creation of one that will provide the greatest tax advantages, and the greatest protection against potential legal liability.

In this guide, we will briefly explain the differences between entities and their advantages and disadvantages. Within our Business Planning Guide you will also find:

- A Deduction Guide to assist you in deciding what types of expenses can be paid from your business.
- A section devoted to record keeping, insurance protection, hiring and payroll.
- A section on additional services we can offer.

It is our sincere hope that this guide will answer basic questions. We encourage you to contact us to discuss your individual circumstances.

We look forward to being of assistance to you.

Sincerely,

A. Ernest Cruz, MBA, JD

TYPES OF ENTITIES

When you start a business, you have many choices to make. One key decision is choosing the form of business entity you will operate under. For starters, you can set up your business as a Sole Proprietorship, Partnership, or Corporation.

SOLE PROPRIETORSHIPS

Doing business as a sole-proprietor eliminates the double taxation curse. There are no corporate taxes to pay, and you only pay individual taxes on your net profits, typically reported on Form 1040, Schedule C. However, as a sole proprietor you lack the legal protection that corporate status gives you. Owners of corporations enjoy limited liability, but sole proprietors do not. Simply stated, if you're a sole proprietor, your personal assets are at risk if the business is sued, very risky indeed!

PARTNERSHIPS

Work relatively the same as a Sole Proprietorship. However, profits are distributed to each partner. Again, this business entity eliminated the double taxation curse but offers no legal protection against each partner's personal assets. In addition, each partner is equally responsible for the deeds or misdeeds of the other partner.

CORPORATIONS

A corporation is a separate legal entity owned by one or more shareholders, and the shareholders have "limited liability." The shareholders elect directors who have overall responsibility for the management of the corporation. The directors elect officers who carry out the wishes of the directors. Thus, a corporation is more complex than either a sole proprietorship or a partnership. However, some of the complexity can be simplified in many small companies by having the shareholders serve as both directors and officers.

A. Organizational Formalities:

1. **Articles of incorporation:** The corporation is formed by filing Articles of Incorporation with the Secretary of State. The Articles must include basic information regarding the names and addresses of the corporation, the registered agent, and the incorporator, as well as the number of authorized shares of stock. In addition, the Articles can include provisions regarding limited liability of the directors, preemptive stock rights, staggered director's terms, and any unusual shareholder meeting requirements.
2. **Organizational Minutes (or Consent):** A corporation is also required to hold an organizational meeting to elect initial directors (unless already named in the Articles of Incorporation), elect officers, adopt Bylaws and take care of other organizational matters. These organizational activities can be handled instead by a written "organizational consent" signed by the incorporator(s) or the initial directors, unless such a method is prohibited in the articles.

3. **Bylaws:** In addition to the Articles of Incorporation, a corporation must have a set of Bylaws which define how the business and affairs of the corporation will be managed and regulated. Typically, a set of Bylaws includes provisions regarding shareholders meetings and voting, and the duties, qualification, election terms and meetings of the directors. The Bylaws (or the Articles) may also include provisions regarding stock transfer restrictions, the execution of written instruments, higher-than-majority quorum requirements for directors meetings, and identification of directors.
4. **Stock Certificates:** A corporation may choose to issue stock certificates as evidence of ownership by the shareholders of their respective interests in the corporation. However, physical certificates are not always required.
5. **Federal Employer Identification Number (EIN):** An EIN must be obtained using Internal Revenue Service tax form “SS-4”. Other forms, applications and licenses may be required, depending on the activities of the corporation. For example, there may be a need to register as a contractor, or the need to obtain a sales tax permit. As well as an identification number with respect to reporting payroll at the state level.
6. **Minutes/Annual Reports:** After formation, the corporation must observe certain formalities in order to preserve its separate legal status. Minutes or other records of shareholders and director action must be prepared at least annually. Additionally, annual reports generally must be filed with the secretary of state.

B. Limited Liability:

The owners of the corporation (the shareholders) enjoy “limited liability”; that is, the shareholders are only liable for the debts and expenses of the corporation up to the amount of their respective investments in the corporation’s stock. However, some state laws may impose liability on the shareholders for unpaid wages in small corporations. Additionally, creditors frequently require the majority shareholder(s) to guarantee the debts of the small corporation or co-sign its notes in their individual capacity, or pledge their personal assets as security for the corporation’s loans.

C. Income Taxation

The income and expenses of a corporation are reported on a separate tax form (Form 1120). Unlike the other forms of business entities, the corporation then pays its own taxes on its net income, instead of allocating the income to the owners. However, alternative tax treatment is available if a “Subchapter S” election is made, described in further detail in the following section.

D. Fringe Benefits

Generally corporations have the most flexibility in deducting the costs of providing three benefits to employees which is especially attractive for employees who are also officers and shareholders.

E. Double Taxation

Shareholders can authorize the payment of dividends to themselves as a means of withdrawing accumulated profits from the corporation. The payment of dividends results in taxable income to the recipient shareholder, even though the corporation already paid tax on that income. This “double-taxation” significantly reduces the “after tax” dollars for the owners. However, this double-taxation consequence is easily avoided in closely-held corporations because the shareholders can simply pay themselves greater wages or bonuses (subject to reasonableness) which are deductible by the corporation (taxable to the shareholders) and therefore a means of “distributing” the corporate profits which are taxed only once.

F. Use of the Regular Corporation

Corporations are formed to gain “limited liability” and in some cases, gain an advantage in deducting fringe benefits.

TYPES OF CORPORATIONS

THE C CORPORATION

C-Corporation generates two levels of federal income tax. The C-Corporation pays one level of tax when it files its federal corporate tax return, Form 1120. A second layer of tax is imposed when the C-Corporation’s profits are distributed to the shareholders as dividends. Those dividends are reported and taxed on the individual’s federal tax return, Form 1040. Together, these two levels of taxes are referred to as “double taxation.” In addition, state taxes also typically apply to both C-Corporation profits and distributed dividends. Overall, the tax picture for corps is far from ideal for small businesses.

THE S CORPORATION

Created in 1958, the S Corporation was, for many years, the standard form of organization for conducting a small business. S Corporation status provides a way for you to avoid the double taxation imposed upon C Corporations and their shareholders. One advantage of the S Corporation is that income is taxed personally to the shareholders. However, your personal risk remains limited to your investment. In other words, double taxation is avoided and you get the protection of limited liability.

Your corporation chooses “S-Status” by filing a special election, Form 2553. Bear in mind that the “S” status of the corporation only impacts taxes. Shareholders of S Corporations have all of the same legal protections as those in C Corporations. However, once you have established an S Corporation, it would first have to be liquidated if you wanted to change to an LLC, and liquidation of a corporation can result in taxable gains to shareholders.

THE LIMITED LIABILITY COMPANY (LLC)

LLCs started in 1977 in Wyoming and have quickly become a popular form of business entity across the country. By default, LLCs with more than one owner (member) are taxed as Partnerships, while single-member LLCs are taxed as sole proprietorships. As with S corporations, with an LLC you only pay taxes with your personal return. However, if you decide to do business as an LLC, you are not stuck with it. Simply by filing a Form 2553 at the appropriate time, an LLC can become an S corporation without having to liquidate. There is little risk of triggering a tax by changing from this form of doing business.

LLPs and LLCs are similar in many ways. One key difference is that LLPs must be owned by more than one individual. Remember, the “P” in LLP stands for partnership—by definition a single individual cannot own a partnership. So if you had an LLP with two owners and one died, serious problems that might even cause the business to close could result.

S CORPORATION VS. LLC

WHAT CHOICE IS BEST FOR YOU?

The choice quickly narrows to an LLC or an S-Corporation. Which is more appropriate for your business?

Well, they are both “pass-through” entities that allow you to avoid double taxation, operating a business without paying corporate taxes. Net profits are reported by the owners in their individual tax returns, and both also offer protection from unlimited liability. Your liability will be limited to your investment in either entity.

When choosing between an S-Corporation and an LLC you need to consider many things. What may be appropriate under one set of circumstances may not be in another. Every business is different, and every owner has different needs and expectations. Let’s review the attributes of each type of entity to help you decide.

DISTINGUISHING CHARACTERISTICS

An S Corporation might be more restrictive than an LLC. There can’t be more than 100 shareholders in an S corporation. In addition, only individuals, estates, and qualifying trusts are permitted shareholders. An S Corporation may not have any non-resident alien shareholders. There can only be one class of stock ownership. Adding a second category of class or ownership terminates the “S” Election, which could lead to unintended and unexpected tax consequences. The income and expenses from an S Corporation are allocated on a per-share/per-day basis. Your businesses’ net income, after paying you a reasonable salary, would not be subject to self-employment taxes on your individual return.

The amount of your investment in the S Corporation—your cost basis—includes:

- 1) Your contributions of cash & property.
- 2) Your share of S corporation profits not distributed to you
- 3) Loans made directly to the Corporation by you

This “Basis” calculation is important because it is your tax cost. The more you have invested, the more “write-offs” you can claim when there are losses.

LLCs offer more flexibility than S corporations. They can have an unlimited number of owners and any person, business or trust can be a member or owner. With an LLC you can choose to allocate particular types of income and expenses between the owners. Doing this can get pretty complicated so be sure to speak with us about “special allocations.” On the negative side, the status of the business’s net income as subject to Self-Employment taxes is unclear. Current thinking is that reasonable compensation should be paid in the form of guaranteed payments subject to SE tax, with the balance of income – attributable to capital or the work of employees – not subject to SE tax.

Your basis in an LLC (your tax cost) includes:

- 1) Your contributions of cash & property
- 2) Your share of LLC profits not distributed to you
- 3) Your share of the LLC debts to others. (In an LLC, loans to the company can increase your tax basis if you are personally liable for them. In an S corporation, only your direct loans to the company can increase your tax basis.)

LLCs provide more ways to increase your tax basis. This illustrates a significant advantage of LLCs over S Corporations. Because of the way these calculations are done, your cost basis may be higher for an investment in an LLC than if you set up shop as an S corporation.

CORPORATE DEDUCTION GUIDE

Corporate Expense Items Paid Through Corporate Checking Account:

- “Ordinary & Necessary” business expenses related to your particular enterprise
- Medical Insurance & Medical Reimbursement
- Auto Leases
- Insurance – Auto
- Auto Fuel & Repairs
- Out of town meals and client entertainment
- Retirement plan payments

Expenses that you *should not* pay from Corporate Checking Account

- Rent or mortgage payment on personal home
- Home utilities
- Home improvement
- Groceries
- Other expenses that are clearly personal in nature

If you have any questions or concerns, feel free to contact us at (800) 337-2059

SETTING UP SHOP

Establishing a corporation is relatively a simple process that we at Nations Business Center, Inc. can assist you with. Regardless of the type of corporation you choose to set up the process begins with us forming Articles of Incorporation containing the following information: who will own the business, the business's activity, address, and other miscellaneous details. Aside from being registered as an "Inc., Co. or Corp." a corporation can also be registered as P.C (Professional Corporation). This designation is for professionals who choose to operate in corporate form and is popular with doctors, lawyers and accountants.

An LLC requires a bit more work to get started. Articles of Organization, to be filed with the state and an Operating Agreement (like a Partnership Agreement), are drafted. In addition, business information about the LLC must be placed in a published ad to give notice to the public that the company is being started. An LLC can choose to be registered as a P.L.L.C. (Professional Limited Liability Company) when its owners are licensed by the state to engage in a professional practice – doctors, lawyers, accountants etc.

Please contact us at (800) 337-2059 regarding the cost to set up your corporation.

RECORD KEEPING

It is highly recommended that accurate records be maintained with regard to earnings and expenses, as well as records regarding occupational licensing, state filings and employee files. These records should be maintained for a period not less than three years.

INSURANCE LIABILITY

Regardless of the entity you choose for your business, insurance liability coverage may be required. As mentioned previously, the personal assets of the shareholders of a corporation are protected. However, other forms of liability coverage may be required if the entity is renting space in a location, has employees that require worker's compensation insurance and or has contracts with governmental agencies.

Other insurance such as fringe benefits are often available to companies at premium rates.

HIRING

When hiring employees or contractors, an employer must keep accurate information regarding the person's name, address and social security number, TIN number or federal ID number. This information is considered to be private and should be securely maintained.

Information regarding hiring practices can be found on state and federal websites.

PAYROLL

Regardless of whether you have employees or contractors, reports with the federal government must be filed either on quarterly or annual basis. Employees of a company also require filing of state employment reports. The reporting process begins with the obtaining of a state identification number known as a UCT number.

Information can be found on state and federal websites.

SERVICES OFFERED THROUGH NATIONS BUSINESS CENTER, INC & AFFILIATED BUSINESSES

Nations Business Center, Inc. offers the following services:

Business Tax Consulting Package offers clients comprehensive professional services for a low flat fee. The package includes IRS & State Audit Representation; creating or modifying a simple will; quarterly Business & Tax Newsletter; unlimited consulting; unlimited accountant recommendation letters; unlimited Financial Statements; and unlimited copies of tax returns. For further information please contact our office.

Payroll Services are provided at rates based on the frequency of payment, method of payment and the number of employees. For further information please contact our office and request a payroll packet which details the services along with a current rate schedule.

Monthly Accounting Services are provided at rates based on the amount of checks written out by the company per month. Within this package of services, we provide financial statements, as well as annual corporate and personal tax report preparation (If entity is an "S" or "LLC/LLP"). Contact our office for specific rates.

Nations Insurance & Financial Advisors LLC in conjunction with our insurance partners can provide you with quotes on commercial liability, workers comp, life insurance, and medical insurance.