Time to Incorporate

Ask a business owner why he or she restructured their business from a sole proprietorship to some other entity — C-corp, S-corp, LLC, ESOP — and the first answer is always: liability. In a sole proprietorship (even a partnership) you, the owner(s), are the business. If, for example, you shortcut building practices or use unlicensed trade partners and something goes wrong, it is you and your personal assets that the insurance companies will go after.

"As a sole proprietor your personal residence is exposed, your children's education is exposed," says Jeff King, who, after five years as a sole proprietor, made his San Francisco company a C-corporation. "You don't want that exposure to go beyond your immediate business. If I'm hit by a bus, the creditors can't go after my home and family, only the business."

Creating a separate entity — or corporation — isn't difficult, but it does require planning and a certain amount of investment.

SO MANY CHOICES

To figure out which structure is for you, ask yourself how you see your future, says Monroe County (N.Y.) Community College business instructor John Striebich, who has owned his own business and consulted for several successful companies. "Do you see yourself as a big regional or national competitor? If so, you might go to a C-corp." The S-corp is intended for smaller businesses, as is the LLC. The LLC is something you might also want to do for image; many professionals such as doctors and lawyers incorporate this way. "You can switch structures," says Streibich, but it costs money to go back and forth."

The C-corp is a separate entity from the business owner. It reports its income and pays taxes on profits. Owners are stockholders and receive dividends, which they report on their personal income tax returns. One drawback: Dividends are taxed as part of the corporation's income *and* as part of the owner's personal income — referred to as "double taxation." Usually larger businesses become C-corporations, especially those that foresee issuing public stock.

About 25 years ago, the IRS created the Subchapter S-corporation to help smaller businesses incorporate. There can be up to 75 shareholders in an S-corp, and there is no double taxation. The business maintains the limited liability of the C-corp but is taxed like a partnership, i.e., it pays no corporate income tax; instead, it passes taxable income or loss on to stockholders.

Many remodelers restructure as an S-corporation, which, Striebich says, "has lower filing and accounting fees. It's sort of 'corporation light.'"

When JD Coussens Inc., in Davenport, Iowa, became an S-corp, owner Jerry Coussens dreamt of one day selling the company to his employees. Currently he owns 100% of the stock. "I had options as a sole proprietor," he says, "but now I have shares I can easily and legally divide."

Like the S-corp, the Limited Liability Company (LLC) does not pay corporate income taxes. Owners are taxed on their personal income tax like a sole proprietor or a partnership, but an LLC is similar to a corporation in that the owner has liability protection.

An LLC is more flexible and easier to set up than an S-corp, which has many more requirements. For instance, profits in an S-corp must be distributed among owners based on the ratio of stock ownership — even if the owners would like to see profits distributed differently. An LLC, however, does not issue stock and there are no restrictions on ownership. Profits can be distributed any way management sees fit. On the other hand, since the LLC doesn't issue stock, stock

Illustrations: top left, Rich Lillash; bottom right, Mary Endres