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Do You Have the Right Structure in Place?

As your company grows, one consideration that will inevitably arise is your professional structure. Options available to small and medium-size businesses include sole proprietorship, general partnership, limited partnership, LLC (limited liability company), C corporation, and S corporation. The majority of small businesses choose S corporation status because it offers some liability protection and potential tax benefits. However, some accountants favor C corporations for small businesses because they provide more favorable deductibility of fringe benefits and allowance of charitable deductions. But, the tradeoff is that income is taxed at both the corporate and personal level.

Sole proprietorship is the default structure for individuals operating a business by themselves. It provides a high degree of financial flexibility and is the cheapest structure to administer, but there is a big taxation downside. Sole proprietorships pay self-employment taxes equal to both the employer and employee share of FICA. Other concerns include the risk of full liability exposure for the owner and potential problems resulting from the lack of business structure after the death of the owner or when the owner wishes to sell, says Eric Kalnins, an attorney and partner at Handler Thayer, LLP.

"For this reason, we generally suggest that clients organize other types of business structures. One that has come to the forefront recently because of its flexibility is the LLC," Kalnins says. LLCs can be owned by multiple individuals or entities, whereas S corporations are limited to one type of stock and in the number and types of shareholders that can obtain ownership interests. For tax purposes, owners can choose to have an LLC treated as either a C or S corporation or as a partnership, he adds.

Does it ever make sense to change a business structure? Yes, it does. Enterprises that start out as sole proprietorships may find it beneficial to switch to S corporation or LLC status as they grow. As long as they continue to take a "reasonable salary," owners may take additional compensation as dividends, exempt from the employer portion of FICA. While the IRS does not define what constitutes a reasonable salary, it offers some guidelines in its article, "[Wage Compensation for S Corporation Officers.](#)"

Inc. Resource: **How to Incorporate**

If you are starting a business, or you already run one but haven't thought strategically about its legal structure—S Corp, C Corp, or LLC—you need to take this matter seriously.