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The ins and outs of choosing a business structure

Choosing the right structure for your company affects more than just the title on your business card. It also impacts how much you pay in taxes, as well as your legal liability for debts incurred or business actions taken. Moreover, your entity choice could change as the business grows, takes on more risk, and requires more capital and partners. According to the IRS, the most common business structures are sole proprietorships, partnerships, corporations and S corporations. Let's take a look at each one.

Sole proprietorships

The most compelling advantage to a sole proprietorship is simplicity. For example, a sole proprietor doesn't need to register the company or file with the IRS — though a license or permit may be required, depending on the business.

Essentially, the business and its owner are one and the same. That means the sole proprietorship itself isn't taxed. Instead, all profits and losses flow to the owner's personal tax return. On the flip side, a sole proprietor is responsible for all debts, losses and other obligations incurred.

Partnerships

Partnerships exist when at least two people share ownership of a business. Each contributes time, skills and money, and is entitled to a percentage of the profits or losses. To establish a partnership the partners usually register with the state, execute a partnership agreement and establish a business name.

One drawback is the "joint and individual" liability that partners assume for the debts and actions taken by the partnership. Each partner is liable for not only his or her own actions, but also those of the other partners.

C corporations

A C corporation is a legal entity in itself. While C corporations raise funds by selling shares (or pieces of ownership) to investors, the organization itself is responsible for debts it incurs or actions it takes.

The safety offered by a corporate structure is a key attraction to many business owners. However, establishing one typically requires more administrative work than that of other business structures. This includes:

- Filing a number of documents with the state, including articles of incorporation,
- Obtaining an Employer Identification Number from the IRS, and
- Publishing annual reports (in many cases).

These requirements often mean higher startup and ongoing costs.

Why LLCs are gaining attention

Another big star in the universe of business structures is the limited liability company (LLC). As their name indicates, LLCs are intended to limit the liability an owner assumes, which typically consists of the amount invested in the business, along with any personal guarantees made.

LLCs also are attractive because the administrative requirements tend to be less rigorous than with other corporate structures. For instance, not all states require LLCs to file annual reports. Instead, each state establishes its own regulations.

This means the LLC itself isn't taxed at the federal level. For federal income taxes, most LLCs can choose to file as a corporation, partnership or sole proprietorship — even if they're typically not required to convert to these structures. Profits or losses then pass through to each of the members (or owners), who report them on their individual returns.

Some LLCs are automatically classified as corporations for federal taxes. And some states do tax LLC income. Because members are considered self-employed, they pay self-employment Medicare and Social Security taxes. Finally, certain businesses, including banks, typically can't structure themselves as LLCs.

Another potential drawback to consider is that C corporations can be taxed multiple times. The organization's profits are taxed, as well as any dividends paid to shareholders or owners. In addition, shareholders who are employees also pay income tax on their wages.

So the tax picture isn't always as simple as the phrase "corporations are taxed twice." C corporation income is taxed at the corporate rate, for which the top rate is currently 35%. In contrast, the highest *personal* rate is 39.6%. Thus, crunching the numbers may reveal that a company and its owners might save taxes by structuring as a C corporation.

S corporations

As its name implies, an S corporation is a specific type of corporation. But, unlike C corporations, S corporations pass their profits and losses through to owners' personal tax returns. Owners employed by an S corporation, however, must receive reasonable, or fair market, salaries. They also need to pay employment taxes on these wages.

Any remaining income from the business can be allocated to the owners as distributions, which aren't subject to employment tax. Depending on the owner's tax bracket, such distributions might not be taxed or may be taxed at a lower level.

A word of warning: The IRS frowns on S corporation owners who take little in compensation and receive most of their money as distributions, presumably as a way to avoid employment taxes. In certain cases, the agency has reclassified some distributions as wages.

Finding the right structure

Each type of business structure offers specific advantages and shortcomings. So, make sure you bring in an accounting professional when choosing or changing your company's entity type. ◈

Joining the migration to EMV cards

If you haven't yet heard the acronym "EMV," or the term "chip card," you soon will. That's because these payment tools are steadily taking hold in the United States. Eventually, they'll replace the magnetic-stripe payment cards many of us now use.

EMV stands for Europay, MasterCard and Visa, and refers to a global payment standard used in more than 2.5 billion chip cards around the globe. The "chip" in an EMV chip card refers to the computer chip embedded within the card.

Secure transactions

Much of the rest of the world has already shifted from magnetic-stripe to EMV chip cards. The reason? Most chip card transactions are more secure than those done with magnetic-stripe cards.

For starters, the security features on the cards make them more difficult to copy or counterfeit. In addition, each payment completed with a chip card generates a one-time security code that authenticates the transaction. Even if someone steals this information from a specific purchase, the code can't be used again.

Contrast that to the static verification data contained in the magnetic stripe of a traditional payment card. A criminal possessing the card, and thus the data, can copy it repeatedly and make purchases.

Come October 2015, many retailers and other businesses in the states that accept credit card payments* must *be able to process EMV chip cards.

Although no payment method is completely immune to hackers and criminals, EMV chip cards have been shown to reduce fraudulent transactions. A 2013 report by the Federal Reserve Bank of Kansas City examined fraud in several countries that had shifted to EMV chip cards. Among its findings: In 2009, the loss rate on card purchase transactions in France, which had been using EMV payment cards for years, was 39% lower than the U.S. rate. The 2009 loss rate in the United Kingdom, which also had shifted to EMV cards, was 13% lower than in the United States.

Card mechanics

You can tell whether you have a chip card by looking at it. The small computer chip will be embedded on the front. Today's cards typically also have a magnetic stripe on the back, so you can use it with merchants that don't yet accept chip cards.

The mechanics of paying with a chip card in a retail store are similar to those used with a magnetic-stripe card. Rather than swipe the card, you typically insert it — face up — in a payment terminal. You may need to sign or enter a personal identification number to finish the payment. Once the terminal indicates the transaction is complete, you can remove the card.

While the transition to EMV chip cards is underway, many terminals will handle payments made with both magnetic-stripe and chip cards. If you accidentally swipe a chip card at a terminal that accepts them, it will prompt you to insert it instead.

Developments ahead

Many U.S. financial institutions have begun issuing chip cards to their customers. As of the end of 2014, 120 million chip cards had been issued, according to the EMV Migration Forum. That number is expected to hit 600 million by the end of 2015.

What's more, come October 2015, many retailers and other businesses in the states that accept credit card payments *must* be able to process EMV chip cards. Businesses that don't offer this capability may bear greater liability if purchases are found to be fraudulent.

No surprises

The shift in the United States to EMV chip cards should lead to lower fraud rates. So if your bank or credit card provider sends you a new card and it looks a little different, don't be surprised. ◈

Want to benefit your loved ones?

Consider split interest trusts

If you're looking for a way to benefit your loved ones, take a good look at charitable remainder trusts (CRTs) and charitable lead trusts (CLTs). Often referred to as "split interest" trusts because of their dual beneficial interests, they have the ability to benefit a qualified charity as well as noncharitable beneficiaries.

How CRTs work

A CRT provides noncharitable beneficiaries with exclusive rights to all distributions until their interests have terminated. At that time, charitable beneficiaries receive the *remainder* — the assets left over in the trust.

A CRT can be a particularly useful tool if you'd like to divest yourself of a highly appreciated asset to diversify your portfolio but are concerned about the capital gains tax. You create a CRT, name yourself the noncharitable beneficiary and transfer the appreciated asset to the trust. Then, the CRT can sell the asset (tax-free to the trust because the CRT is tax-exempt) and use the proceeds to purchase diverse, income-producing assets.

You can receive annual payments from the trust for a specified period of up to 20 years or for your lifetime, increasing your cash flow. A portion of each payment may be taxable to you based on the income earned or capital gains recognized by the trust. You might, for instance, have capital gains income attributable to the sale of the highly appreciated shares you transferred to the trust. But the gain you report will be spread out and taxed to you only as you receive payments.

In addition, you'll enjoy an immediate income tax charitable deduction on creation of the trust, calculated as the present value of the charity's remainder interest. You also can enjoy recognition within the charitable organization(s) and community as a result of the contribution, unless you prefer to donate anonymously.

You can receive annual payments from a CRT for a specified period of up to 20 years or for your lifetime, increasing your cash flow.

If you're concerned that, should you die early in the CRT's existence (before you've received many payments from it), there won't be enough assets in your estate for your heirs to receive the inheritances you intended, there are at least two potential solutions.

One is to set the CRT term for a specific number of years (rather than your lifetime) and name your heirs as contingent beneficiaries. The other is to purchase a life insurance policy to make up for the shortfall your heirs might experience.

Finally, keep in mind that you can name someone other than yourself as a noncharitable beneficiary and even fund the trust at your death, but the tax consequences will be different.

Where CLTs differ

A CLT differs from a CRT in that it reverses the timing of when charitable and noncharitable beneficiaries receive distributions. That is, charitable beneficiaries receive the initial distributions and noncharitable beneficiaries receive the remainder.

A CLT can be useful when an asset generates substantial income every year, you don't need the income and you wish to eventually pass the asset to your heirs. The CLT generates an income stream for the charity during the trust term, and at your death (or the end of the CLT term, if you've set it for a specific number of years) the asset passes to your family.

If structured as a grantor trust, the trust is essentially disregarded for income tax purposes, and a CLT then works similarly to a CRT in that you receive an immediate income tax deduction on the transfer of assets into the trust. But, in subsequent years, the income generated by the CLT will be taxable to you. If you don't structure it as a grantor trust, the CLT income won't be taxable to you, but you also won't get an income tax deduction when you fund the trust.

Unlike a CRT with you as the noncharitable beneficiary, a CLT has a gift tax component, which is calculated as the present value of the noncharitable beneficiary's remainder interest. As with CRTs, CLTs can also be funded at your death, but the tax consequences will be different.

Who can help

In the world of estate planning, harnessing the power of either a CRT or CLT can help the charities you support while also benefiting your beneficiaries. So, consult with your tax advisor to see whether a CRT or CLT suits your estate plan. ⟐

Tick tock

4 ways you can beat the clock with time management

One resource limitation that all business owners face is time. Although science has yet to develop a way to add more hours to the day, it *is* possible to get more from each one. Here are four ways to beat the clock:

1. Prioritize activities only you and your staff can do.

Many companies outsource functions outside their core areas of expertise, such as payroll or taxes, to focus on activities that add the most value to their business. Delegating tasks shouldn't be a luxury reserved for businesses that have achieved a certain size or level of success.

Hiring experts to handle functions in which a business lacks knowledge — say, designing a website or drafting a contract — frees up time for more mission-critical activities. For example, you probably wouldn't want to outsource interacting with your customers or providing the products or services you're known for. But engaging outside providers to *support* these functions may be a good idea.

2. Put goals in writing and tell others about them.

Taking time to write down goals and provide progress updates can help you reach them. Consider a study by Gail Matthews, a psychology professor at Dominican University of California. More than 75% of participants who put their goals in writing and sent a friend weekly progress reports either accomplished them or were well on their way by the study's conclusion. Just 43% of those who simply thought about their goals could say the same.

3. Forget multitasking.

For time-pressed business owners, multitasking can seem like an answer to a prayer. In theory, doing two things at once should double productivity. But, in reality, the quality of one's work can suffer when switching between tasks.

Researchers at George Mason University examined essays written when subjects were left alone, and when they were interrupted. They found the quality of the essays, as measured by word count and number of ideas conveyed, decreased among participants who were interrupted.

These findings can apply to any projects requiring creativity or complex thinking. Typically, people need to immerse themselves in an activity until reaching a natural stopping point.

4. Make meetings productive.

To avoid meetings that eat up time, and produce little benefit, verify whether they're really needed. If information simply will be exchanged, e-mail may suffice.

If a meeting is necessary, draw up an agenda and distribute it beforehand. Instruct everyone to come prepared. And keep the attendee list as small as possible. ◈