

ECE 09.461

CLINIC CONSULTANT IN

ELECTRICAL & COMPUTER ENG.

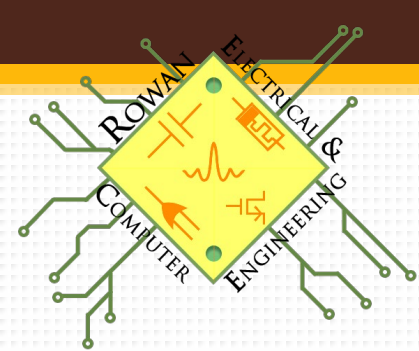
LECTURE 4

BECOMING A CONSULTANT: STARTING A BUSINESS

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ELECTRICAL & COMPUTER ENGINEERING





THIS WEEK IN CC: To LLC OR NOT To LLC

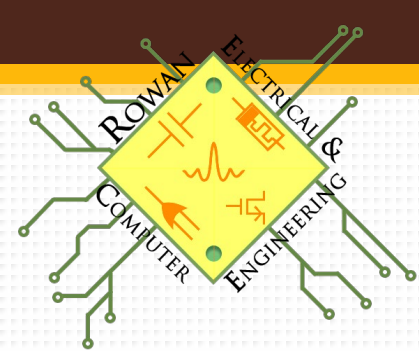
- How to structure your business?
- Structure, advantages and disadvantages of different types of business entities:
 - Sole Proprietorships
 - Partnerships
 - Limited Liability Companies (LLC)
 - Corporations
- Starting a business in New Jersey

References: NOLO

[Business Ownership Structures](#)

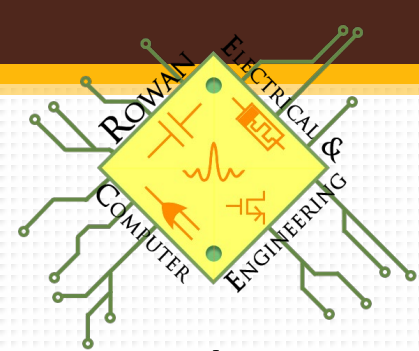
[Should You Form an LLC for Your Consulting Business?](#)

[Piercing the Corporate Veil: When LLCs and Corporations May be at Risk](#)



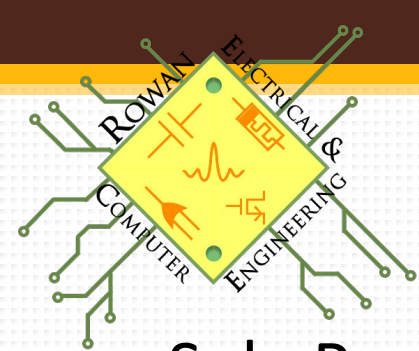
HOW TO STRUCTURE YOUR CONSULTING BUSINESS?

- When deciding to get into the consulting business, one of the first decisions you have to make is the type of *business entity* you want to form.
- The type of business entity you form has many consequences:
 - Ease of set up (formation)
 - Liability
 - Taxes
 - Control over the business
- ... so think carefully before making that decision.



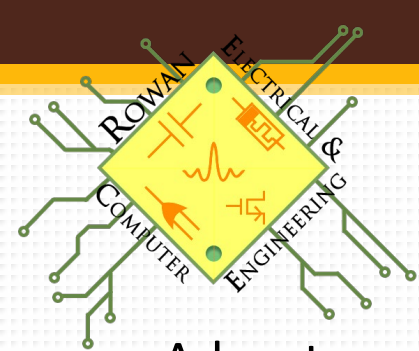
BUSINESS ENTITY...?

- There are several types of business entities you can operate under. The most common ones are:
 - Sole Proprietorships
 - Partnerships
 - Limited Liability Companies (LLC)
- Less common ones – at least for consulting businesses
 - Corporations
 - Non-profit corporations
 - Cooperatives



SOLE PROP...WHAT?

- **Sole Proprietorships** – this is the simplest type of business entity.
 - Here is the list of things that you have to do to form a sole proprietorship:
 - **Step 1: Decide to have a Sole Proprietorship**
 - **...and that completes the list**
 - A sole proprietorship is simply a one-person business that is not officially registered with the State government.
 - You do not need to do anything to form sole proprietorships: no filing, no paperwork to have such a business.
 - In sole proprietorships, the business is legally not a separate entity from its owner: the income, loss, assets and liabilities of the business, are the personal income, loss, assets and liabilities of its owner.
 - **Be aware of that last part: the liability of the business is the liability of its owner!**
 - **If the business is sued, or has a court judgment against it, the owner is personally responsible.**



SOLE PROPRIETORSHIPS

- **Advantages:**

- Simple to start – no paperwork or registration is needed, no fee to pay.
- Complete control over the business, no partners, no shareholders.
- No corporate tax – the business income is taxed as your ordinary income (pass-through income)
 - **You report business income / expenses on your individual Form 1040 / Schedule C**
 - **and may be eligible for the new 20% pass-through tax deduction***
- You own all of the income and all of the profit of your business

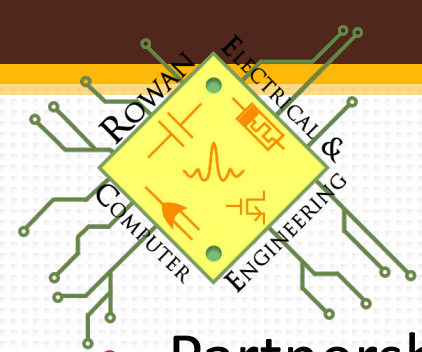
- **Disadvantages**

- You are personally liable for all taxes, debts, obligations, and court judgments against your business.
 - **You need to withhold necessary taxes, e.g., self-employment taxes, Social Security and Medicare**
- Extremely unlikely that an investor will give you funding (should you ever need it)
- You cannot really sell this “entity” to someone else later.

- **Shall I use sole proprietorship for my consulting business? Yes, if:**

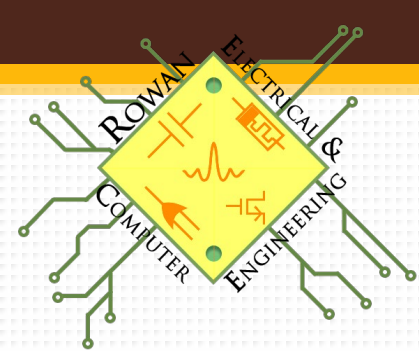
- You are unlikely to be sued, you are unlikely to rack up big debts
- You will not need to borrow (much) to run your business.

**consult a tax advisor.*



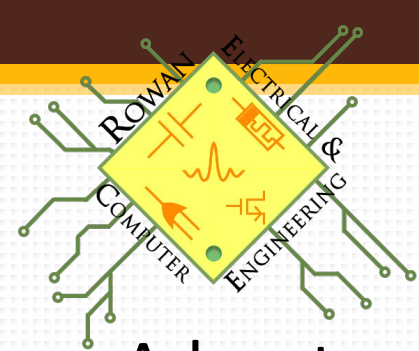
PARTNERSHIPS

- Partnerships are just like sole proprietorship, except for two or more partners.
- Much of the advantages and disadvantages of sole proprietorship apply to partnerships:
 - Advantages: simple to form - no fuss, no paperwork; pass through taxation;
 - Disadvantages: share the profit/loss with the partners; no protection on liability – including those due to partners' action!
 - All other dis/advantages of sole proprietorship also apply
- Shall I use a partnership for my consulting business? Yes, but only if:
 - Your consulting business relies on the expertise of your partner(s)
 - You are unlikely to be sued, you are unlikely to rack up big debts
 - **And you have complete trust in your partners and their actions**
 - You will not need to borrow (much) to run your business.



LIMITED LIABILITY COMPANIES (LLCs)

- For most small businesses, operating as a limited liability company (LLC) is the most logical option.
- While it does require registering with the State government (read: has some paperwork 📄), it is not too onerous, but the main benefit is protection against personal liability.
- Other than the initial cost and filing needed for registration, LLCs share most of the advantages of sole proprietorship, while protecting against their biggest disadvantage.

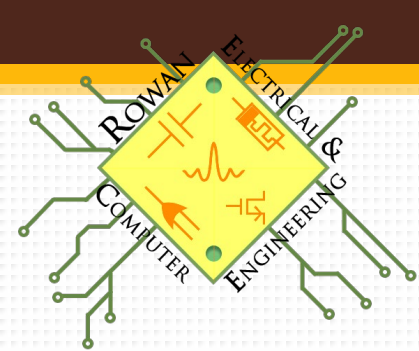


LIMITED LIABILITY COMPANIES (LLCs)

- Advantages:

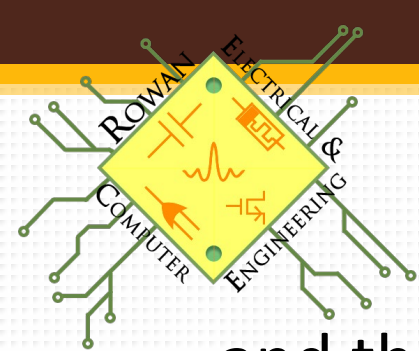
- Relatively simple and inexpensive to start compared to some other forms of businesses (such as corporations)
- No corporate tax* – the business income is taxed as your ordinary income (pass-through income); and may also be eligible for the 20% pass-through tax deduction
- Flexible management: you can have partners and members of the LLC, and still not have to report to a board.
- Business recognition: you are better recognized as a professional business, and hence, potential clients may trust your “company” more than a sole proprietor. You may also have a better chance of raising funds from an investor.
- And the biggest benefit: as the name implies: **limited liability**. Owner of an LLC is generally not personally liable for the debts and obligations of the business as long as you play by the rules.

* unless you choose to follow a C Corporation tax status – consult a tax advisor, as these issues can get more complex.



ABOUT THAT “PLAYING BY THE RULES”

- You can lose your liability protection by a court order (also called “piercing corporate veil”), if:
 - You do not formally separate your personal and business finances:
 - **Paying personal bills using business account or vice versa (comingling assets)**
 - **Follow proper corporate formalities and record-keeping rules (e.g., hold regular meetings with directors, record all decisions in meeting minutes, adopt company bylaws, etc.)**
 - **Otherwise act as if you and the business are one and the same**
 - You act fraudulently, wrongfully, or maliciously
 - **The business irresponsibly borrows and loses money, thinking that the LLC provides personal liability protection against losses**
 - Your creditors face an unfair, unnecessary, unexpected cost because of your actions
- Closely held corporations and LLCs (those owned by one or few people) are most at risk of having their corporate veil pierced



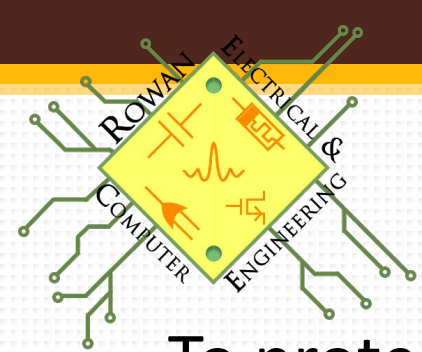
LIMITED LIABILITY COMPANIES (LLCs)

- ...and the disadvantages:

- Well, there is (some) paperwork / registration with your State in order to form an LLC
- You may be subject to additional tax (such as franchise tax) in some states (such as California)
- You ***must*** keep your personal and business assets / bank accounts / spending separate
 - **This is a biggie! If you do not, you can lose the liability protection!**
- Still less likely that an investor will give you funding, compared to a corporation.

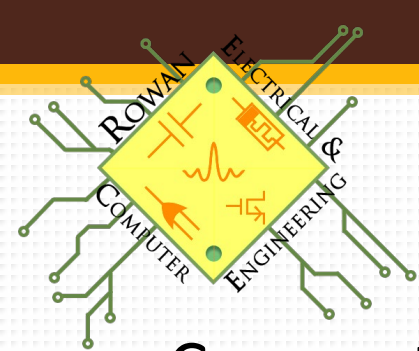
- Shall I use LLC for my consulting business? Yes, if:

- There is a likelihood that you may be sued, and/or racking up big debts
- You have lots of personal assets that you want to protect from business liability
- You will not need to borrow (much) to run your business.



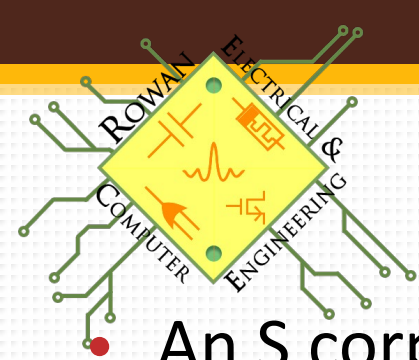
PROTECT YOURSELF!

- To protect yourself from being personally responsible for your LLC business debt / loss, make sure to:
 - Do not commingle your assets with those of the business: maintain a separate bank account for your LLC. All business income should go to that account, and all business expenses should be paid from that account.
 - **So..., how do you get paid?**
 - Comply with formal business practices for establishing and maintaining a business: keep meeting minutes, file necessary legal forms, have bylaws.
 - Make sure the business is properly capitalized (funded)
 - Do not tell anyone – ever – that you personally guarantee the business's work, liabilities, or other debt.
 - Clearly tell everyone that they are doing business with an LLC: have “LLC” be part of your business name (and show on business cards, invoices, etc.)
 - Do not engage in any illegal, reckless, negligent activity



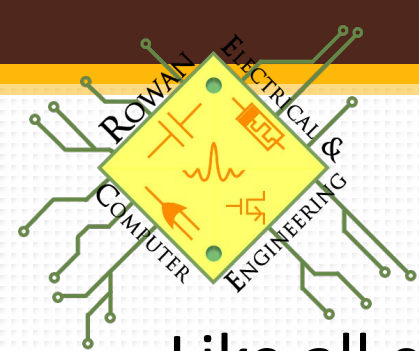
CORPORATIONS

- Corporations are entirely separate business entities from their owners, both as a legal entity, as well as a tax entity.
- They have a more complex structure, such as having boards and shareholders
 - Owners of a corporation are shareholders (stockholders), who elect a board that manages the activities of the corporation.
- Corporations – by virtue of being entirely separate entities – also provide liability protection to their owners.
- There are two main types of corporations
 - C Corporations
 - S Corporations



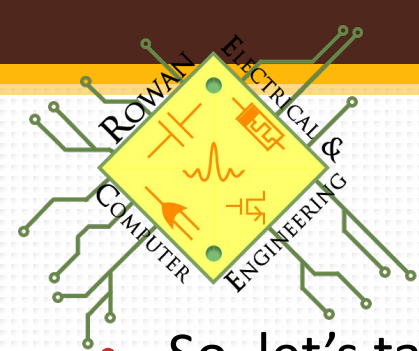
S CORPORATION

- An S corporation is not really a business entity, but rather a federal tax status: the name comes from such an entity choosing to be taxed under Subchapter S of the IRS code.
 - So, an LLC may choose to be an S-corporation (and many do!), or even a C corporation
 - S Corps are pass-through entities (just like LLCs and sole proprietorships): taxes on profits are paid through the personal income taxes of its owners.
 - ...and benefit from the 20% qualified business income (QBI) tax deduction
 - ... and they can declare losses and use them to offset some other profit.
- S corporations are designed for small businesses that satisfy these conditions:
 - Owned by US persons
 - Cannot have more than 100 shareholders
 - Have only one class of stock – all shareholders must be treated the same



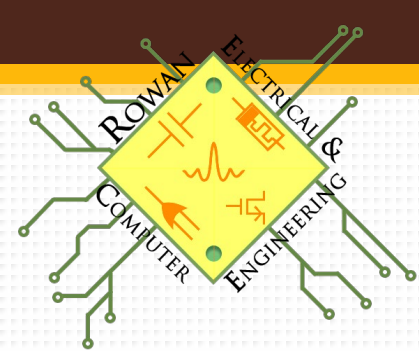
C CORPORATION

- Like all corporations, C corporations are incorporated in their state, have a board of directors, which hire managers or officers to conduct the day-to-day activities.
- C corporations are typically large, for-profit corporations
 - May have foreign owners
 - Can have an unlimited number of shareholders
 - Can have different classes of stocks, with the ability to treat different shareholders differently (for example, some may have different voting rights)
 - They must distribute stock shares to their owners (shareholders)
- C corporations must pay corporate taxes (21%) on profits and any profit distributed to owners are also taxed as personal income: double taxation!
- When someone files a claim against the C corporation, the owners are usually not personally liable.



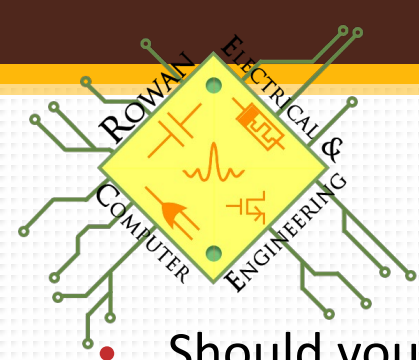
CORPORATIONS

- So, let's take a look at the advantages and disadvantages of corporations:
- **Advantages:**
 - Very favorable to investors, because they can be shareholders (hence owners) of the company
 - Owners do not pay taxes for the (S) corporation's business income, but only personal income for the compensation provided by the Corporation
 - Shareholders have (limited) liability protection
- **Disadvantages**
 - Difficult and complex to form and maintain.
 - Expensive to form and maintain with filing fees, annual fees, etc.
 - Higher taxes
 - More complex structure and the requirement to maintain such a structure (must have a Board)
- **Shall I use Corporation for my consulting business?**
 - Generally, no.
 - But, if you want to grow it, it may make sense to have a S Corporation



BOTTOM LINE

- For most consulting type businesses, you are most likely to operate as a:
 - Sole proprietorship, if you work alone and have low risk of being sued
 - Partnership, if you have partner(s), but low risk of being sued
 - Limited liability company, if there is an elevated risk of being sued, and have substantial personal assets that you want to protect from business risk.



STARTING A BUSINESS IN NEW JERSEY

Should you choose to form a formal business entity in the State of New Jersey:

- Start here:
<https://business.nj.gov/>
- Choose the type of business entity / structure you want to form
<https://business.nj.gov/pages/choose-a-business-structure>
- Register your business:
<https://business.nj.gov/pages/register-your-business>
- Check if you need licensing / certification:
<https://business.nj.gov/licensing-and-certification-guide>
- Do you need to hire employees?
<https://business.nj.gov/pages/hiring-employees>
- Create a free, personalized guide to register and find funding for your business:
<https://navigator.business.nj.gov/>
- Registering and for paying taxes
<https://business.nj.gov/pages/register-for-taxes>
- General tax guidance for starting a business in NJ
<https://www.state.nj.us/treasury/taxation/documents/pdf/guides/Starting-a-Business-in-New-Jersey.pdf>

