

512 words

Abstract: If a small business is operated as a sole proprietorship, the owner may have thought about forming a limited liability company (LLC) to protect his or her assets. Or, if the owner is launching a new business, he or she may want to know what options are available for setting it up. This article explains the basics of operating as an LLC and why it might be a good choice for a small enterprise.

The advantages of using an LLC for your small business

If you operate your small business as a sole proprietorship, you may have thought about forming a limited liability company (LLC) to protect your assets. Or maybe you're launching a new business and want to know the options for setting it up. Here are the basics of operating as an LLC and why it might be a good choice for your business.

An LLC is a bit of a hybrid entity, because it can be structured to resemble a corporation for owner liability purposes and a partnership for federal tax purposes. This duality may provide owners with the best of both worlds.

Protect your personal assets

Like the shareholders of a corporation, the owners of an LLC (called members rather than shareholders or partners) generally aren't liable for the debts of the business except to the extent of their investment. Thus, the owners can operate the business with the security of knowing that their personal assets are generally protected from the entity's creditors.

This protection is much greater than that afforded by partnerships. In a partnership, the general partners are personally liable for the debts of the business. Even limited partners, if they actively participate in managing their businesses, can have personal liability.

Consider tax issues

The owners of an LLC can elect under the "check-the-box" rules to have the entity treated as a partnership for federal tax purposes. This can provide a number of benefits to owners. For example, partnership earnings aren't subject to an entity-level tax. Instead, they flow through to the owners in proportion to the owners' respective interests in profits, are reported on the owners' individual returns and are taxed only once.

To the extent the income passed through to you is qualified business income, you'll be eligible to take the Code Section 199A qualified business income deduction, subject to various limitations. (However, keep in mind that this deduction is temporary. It's available through 2025, unless Congress acts to extend it.)

In addition, since you're actively managing the business, you can deduct on your individual tax return your ratable shares of any losses the business generates. This, in effect, allows you to shelter other income that you (and your spouse, if you're married) may have.

An LLC that's taxable as a partnership can provide special allocations of tax benefits to specific partners. This can be a notable reason for using an LLC over an S corporation (a form of business that provides tax treatment that's similar to a partnership). Another reason for using an LLC rather than an S corp is that LLCs aren't subject to the restrictions the federal tax code imposes on S corps regarding the number of owners and the types of ownership interests that may be issued.

Consider all angles

In conclusion, an LLC can give you corporate-like protection from creditors while providing the benefits of taxation as a partnership. For these reasons, you may want to consider operating your business as an LLC. Contact us to discuss in more detail how an LLC might be an appropriate choice for you and any other owners.

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