

# WOMEN'S BUSINESS<sup>®</sup>

BOSTON

Covering Massachusetts, New Hampshire and Rhode Island

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THE PROFESSIONAL AND BUSINESS WOMAN'S JOURNAL

LAW

## Choose the Right Entity for Your Business



Gina M. Ghioldi

Choosing the right legal entity for your business involves an in-depth analysis by you and your legal advisor. But it can certainly be worth the effort. The Center for Women's Business Research reports that 41.3 percent of all privately held firms in Massachusetts are owned by women, and that these businesses are generating nearly \$42 billion a year in sales.

With women starting businesses at two times the rate of men, there's never been a better time to "go for it." Here's what you need to do and know before you sit down with your lawyer.

**First**, take an honest, objective look at what your business will look like now and five years down the road. Don't be modest. How much money do you expect to generate? Whom do you envision as your clients? Will you have vendors? How about employees or independent contractors working for you?

And perhaps most important, do you anticipate sharing ownership of the business now or in the future, or will you need to bring in investors? Remember, there has to be a very good reason for sharing a piece of the pie. Unnecessary cooks in the kitchen can become a recipe for disaster. Think carefully about the long-term benefits of bringing someone else in, and whether you really have to do it at the formation stage of your business.

All of these issues come into play when choosing your business entity. Also, think about where you will be conducting business. Sharing an office or subletting from like professionals can present liability concerns that you and your attorney will need to consider when determining what entity is right for you.

**Next**, sit down and have a heart-to-heart talk with your CPA. There are several legal entities that can

limit your liability, but each can have significantly different tax ramifications. Your current financial situation can be an important variable in determining what type of entity your business will be.

Talk with your CPA about your personal financial circumstances and what income you expect to earn. Will you need to invest significant sums of money into getting started? Do you expect to personally derive an income in the first year? And don't forget to make sure you specifically ask your CPA if she or he has experience working with corporations and limited liability companies. Attorneys often consult with a client's tax advisor when forming their new business entity, and you want to make sure you've got the right person for the job.

**Finally**, educate yourself on the various business entities available to you. There are many entity forms but the most common are sole proprietorship, general partnership, limited partnership, corporation (a sub-chapter S corporation or "S-Corp" is an election you make with the IRS; you still file with the Secretary of State's Office as a corporation), limited liability partnership (LLP) and limited liability company (LLC).

- *The simplest entities* are the sole proprietorship and general partnership (more than one owner). They are easy to form and don't require the filing of separate tax returns (all profits and losses are declared on the owners' personal tax returns), but owners are personally on the hook for any debts of the business.

In the case of a partnership, each partner is personally responsible for any debt or liability incurred by the other! This means that your house, your car, your investments and even your future earnings are up for grabs if a claim is successfully brought against the business. You also are typically required to pay self-employment tax on any income derived from the business (as opposed to a corporation in which shareholders may often be entitled to take

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equity distributions which are not subject to the 15-percent tax).

- *Limited partnerships* may offer more protection to partners who provide capital but have no involvement in the managerial of the business, but they can still be found liable for any debts up to the amount of their contribution. The annual filing fee is \$200. Limited liability partnerships are often preferable in that each partner may limit her liability solely to her own negligence, wrongful acts, errors and omissions. The annual filing fee for an LLP is \$500.

- *A corporation* is business structure that is a legal entity separate from its owners. One person may be the sole shareholder, director and officers of the corporation. The Articles of Organization and By-Laws (in conjunction with MGL Ch. 156D) provide guidelines by which the business will operate. Shareholders are not personally liable for the debts of the corporations so long as all necessary formalities are being followed (it is important, however, to note that licensed professionals may not avoid liability for their own negligence even if their services are provided in the name of their corporation). There is a continuity of life, meaning that even if the shareholders die the corporation remains in existence until dissolved. Consideration must be given to issues such as the restriction of the sale of stock, annual meetings, keeping of minutes, and the election of officers and directors.

Unless the corporation has obtained sub-chapter S status from the IRS (which must be formally elected in a timely manner), there is double taxation on earnings. S corporations must follow certain IRS

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requirements to maintain their preferred tax status. Most small businesses that do not anticipate seeking venture capital are best served by electing “S” Corp status. The initial filing fee a Corporation is \$275 and each year thereafter the corporation must file \$125 with its annual report.

- *A limited liability company (LLC)* is another preferred entity that effectively protects owners (called “members” rather than shareholders) from liability.

Massachusetts now recognizes a one-person LLC. Unlike a corporation, there are no corporate formalities to follow except those set forth in the entity’s operating agreement. There is an annual filing fee of \$500. LLCs do not traditionally offer stock options or “go public,” although an LLC may be converted to a corporation if desired. An LLC may also choose to be taxed like a corporation.

It doesn’t matter whether you have always had a burning desire to be an entrepreneur, just came up with a great idea, or can’t find a job. If your entrepreneurial time clock is ticking, the time’s right to start a business or, if your existing business is ready for the next level, then it’s time to get legally savvy. A little knowledge can go a long way toward empowering you with the information you need to choose the right business entity.

*Gina M. Ghioldi, Esq., is the founder of The Law Office of Gina M. Ghioldi, PC, a civil practice in Lexington concentrating in small business law, divorce and estate planning. Ghioldi also hosts her own radio show, The Brass Ring©, which airs every Saturday at noon on WBNW 1120AM and WPLM 1390AM.*