Chapter Six
Limited Liability Companies

I have discussed various for-profit business structures for authors including sole proprietorships, partnerships and corporations. You may have heard about another type of business structure called a Limited Liability Company or LLC. LLCs are a very popular and relatively new business structure, only becoming legal in all 50 states in the 1980s.

Benefits of LLC Status

LLCs can be confusing because they are sometimes thought of as a corporation, but the C in LLC stands for *company,* not corporation. The confusion may come about because LLCs can chose the way they are taxed, as a sole proprietorship, partnership or corporation. Although an LLC is not necessarily a corporation, it does offer several benefits similar to corporations, partnerships and sole proprietorships.

- LLCs offer limited liability protection. Limited liability means that the owners are not personally liable for the debts and liabilities of the business. In this way they are similar to corporations. For example, if an LLC files bankruptcy, the owner will not be required to cover the debts with his or her own money. Alternatively, a sole proprietor is fully responsible for all business debts. Of course, there are situations where an LLC owner can be held liable such as personally guaranteeing a loan, intermingling funds and violating the law. The advantage of limited liability is the main reason why authors and other small business owners choose LLC status for their business.

  Example: A ghost writer was sued for breech of contract. Fortunately, he had limited liability status for his writing business. This protected his personal assets from liability while he fought the lawsuit. Only his business assets were in potential danger. (By the way, he won the lawsuit).

- LLCs are very flexible and can have from one owner to several owners (called “members”). A single member LLC is a sole proprietorship with only one owner.

- An LLC can chose to be taxed as a sole proprietor, partnership, S corporation or C corporation. In other words, you do not cease operating as a sole proprietorship (or partnership or corporation) when you form an LLC.

- An LLC is a separate, distinct legal entity. The LLC owner can open a checking account, obtain a lease and enter into agreements in the name of the LLC and not as an individual.

- LLC is a legal status in your state; it is not a tax status with the IRS. An LLC is a "disregarded entity" for tax purposes meaning that the taxes are reported the same way as before the LLC status was granted. A single member LLC files the same tax return as a sole proprietorship (Schedule C on the Form 1040). A multi-member LLC files either a partnership or corporate income tax return depending on how they are structured.

- LLCs are not subject to double taxation by paying taxes on income and shareholders being taxed on dividends like a corporation. An LLC is what the IRS calls a "pass-through entity." All of the profits and losses of the LLC "pass through" the business to the owners who report this information on their personal tax returns. The LLC itself does not pay federal income taxes, but some states may impose an annual tax.

  True Story: My accounting business, Carol Topp, CPA, was operated as a sole proprietor for its first six years in business. After six years, I was attracting more clients, some from across the country, and I was generating more income. In addition to obtaining professional liability insurance, I formed my business as an single member LLC in my home state by filing the paperwork and paying a $125 fee. My business name is now Carol Topp, CPA, LLC and I still file the Schedule C as a sole proprietor with my Form 1040 tax return and pay self-employment taxes.

Disadvantages of LLC Status

The disadvantages to forming an LLC are small compared to their advantages:

- There is formal paperwork to be filed with your state and an accompanying fee. Oftentimes the paperwork is fairly straightforward, especially for single member LLCs. Some individuals file for LLC status without assistance, but I always recommend you seek professional advice to understand the pros and cons of LLC for your business. If your LLC has multiple members or is a complex arrangement, you should hire a business attorney to assist you in establishing your LLC.

- Earnings from a single-member LLC are still subject to self-employment taxes, just like a sole proprietorship. Your tax structure does not change by having limited liability status.

- Some states impose franchise tax, an annual registration fee or a renewal fee on LLCs. In most states, the fee is about $100, but California charges a minimum $800 franchise tax per year on LLCs. To determine your state's requirements visit your Secretary of State's website. See the Resources chapter for some helpful websites.

- There are other disadvantages that are specific to partnerships and corporations formed as LLCs. These are beyond the scope of this book. If you are considering a multi-member, partnership or corporate LLC, hire a knowledgeable CPA and business attorney to review the arrangement.

When to Consider Limited Liability Status

- You wish limited liability to protect your personal assets.
- You understand the fees, annual reporting and taxes your state may levy on LLCs.
- You can afford to consult with a business attorney to fully understand the legal implications of LLC status.