
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.

What LLC Means and What It Doesn't Mean

A new member to my writers group told us her writing business was structured as a corporation. As a certified public accountant, I found that a little odd. I didn't know Connie well, but she told us she had just written her first book, a self-published memoir. Why would a brand new author want corporate status for a self-published memoir, I wondered? It seemed overly complex to me, so I asked her why she had formed a corporation. "I don't know," she said, "It's what my lawyer and CPA set up." Now I was really concerned. She had two professionals set her up in a complex business structure when she hadn't yet sold one copy of her book! Upon further questioning she

explained. “Oh, they set up an LLC.” Now that made sense. Connie was referring to LLC status.

Benefits of LLC Status

LLCs can be confusing because they are sometimes thought of as a corporation (that was how Connie in the example above got confused). They are quite different. LLC status is a legal standing granted by your state (not the IRS), and it offers limited liability to protect your personal assets from any business liabilities. The confusion may come about because LLCs can choose the way they are set up and 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 breach 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 set up and 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 a 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. Often times 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 LLC 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.

- You can afford to hire an attorney to prepare the legal documents, especially if you are forming a multi-member LLC.

Protecting Your LLC Status

For many years the protection of limited liability was only available to corporations. In the 1980s LLC status became legal in all 50 states and sole proprietors signed up in droves. Finally, they could receive limited liability protection without the complexities of corporate status. It all seemed too good to be true, and perhaps it was.

Lately, limited liability status has been challenged in court, and several business owners found that their personal assets were at risk. To avoid piercing your limited liability protection, you must keep your business assets separate from your personal life. Mixing assets may lead a court to determine that your LLC status is weak and therefore hold you personally liable for the LLC's debts. "It isn't enough for business people merely to have a liability shield; they must also take reasonable measures to protect this shield," cautions New Hampshire attorney John Cunningham.

There are several ways to protect your limited-liability status:

- Don't commit fraud. Even LLC status can't protect you if you're a crook!
- Set up a separate checking account for your business.
- Avoid treating business assets as your own.
- Avoid personal guarantees on business loans.
- Purchase professional liability insurance.
- Sign contracts in the name of your LLC.

In a Nutshell

There is no single best form of ownership for a writing business. The decision will depend on the nature of your work, the income it generates and your personal priorities. You may need to re-evaluate your choice of entity as your business grows. A business attorney or CPA can help you decide which business structure is best for you.