

BUSINESS LAW REPORT

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Prepared by JAY D. FULLMAN A PROFESSIONAL CORPORATION
800 SOUTH BEACH BOULEVARD, SUITE A, LA HABRA, CALIFORNIA 90631
Telephone (562) 694-6005 or (714) 255-2960; Facsimile (562) 697-7700
E-Mail: jdfullman@mminternet.com

Reasons to Incorporate a Sole Proprietorship or Partnership by Jay D. Fullman

When most people hear "corporation," they think "big business." True, most large businesses are corporations. However, a business does not need to be large, or be publicly traded, to secure the benefits of incorporating. The owner(s) of a partnership, a sole proprietorship, or even a potentially money-making hobby, may benefit by incorporating. Reasons to incorporate a business include:

- 1. Limited Liability.** One of the identifying characteristics of a corporation is that liability arising from corporate activity rests on the corporation, not on the stockholders.
- 2. Health Insurance Deduction.** A corporation can provide its employees with medical and dental insurance, which is fully deductible (instead of partially deductible for sole proprietors).
- 3. Medical Reimbursement Plan.** A corporation can pay any uninsured medical expenses of employees and take a tax deduction for the amounts paid. This includes expenses incurred for hospitals, doctors, chiropractors, physical therapists, dentists, orthodontists, and prescriptions.
- 4. Life Insurance.** A corporation can provide up to \$50,000 life insurance tax free to employees and deduct the expense.
- 5. Disability Insurance.** A corporation can provide tax-free disability insurance for employees and fully deduct the cost.
- 6. Automobiles.** A corporation can provide its employees with

automobiles for business use and deduct the expense.

7. Equipment. Usually, up to \$19,000 worth of equipment can be expensed by a corporation instead of depreciated. Or, the shareholders can own equipment, and lease the equipment to the corporation.

8. Dependent Care. A corporation can provide child care services for its employees and deduct the cost, or pay for child care services elsewhere and deduct the cost.

9. Education. Education expenses paid for corporate employees are fully deductible within certain limits, so long as the education is work related. The cost of work related seminars is also a deductible expense for the corporation.

10. Retirement Plans. A corporation can deduct (a) the cost of retirement plan administration, and (b) sums contributed to qualified retirement plans. Applicable retirement plans include SIMPLE (Savings Incentive Match Plan for Employees), 401(k) plans, SEP (Simplified Employee Pension) plans, and profit sharing plans. There are limits on the amounts the corporation can contribute to the plans on a tax-free basis.

11. Lower Tax Audit Risk. Based upon historical experience, a business operated as a corporation (with gross receipts of less than \$1 million) is less likely to be audited than are individuals operating a business that is not incorporated.

12. Carry Forward and Carry Back of Losses. A corporation's capital or operating losses can be carried back or carried forward with very few restrictions.

13. Imposed Discipline for Business Records. Maintaining a business as a corporation requires the adoption and implementation of sound financial and record keeping practices.

14. Possible Income (and tax payment) Deferral. Through the use of a fiscal year other than a calendar year, a corporation can defer payment of taxes.

Shareholders of a corporation who are also employees of the corporation should assure they are taking full advantage of these benefits of corporate status.

These corporate benefits assume that the corporation is a regular "C" corporation. Not all of these benefits are available, or the benefits may be limited, if subchapter "S" corporate status is elected instead of regular "C" corporation status. Some business owners prefer subchapter "S" status because corporate profits are not taxed at the corporate level, but "pass through" to the shareholders. Some business owners also prefer subchapter "S" status because the assets of the business can eventually be sold without capital gains.

Instead of forming "C" or "S" corporations, some business owners prefer to form a limited partnership, a limited liability company, a professional corporation, or a limited liability partnership.

For advice regarding your specific needs regarding entity formation and operation, contact Jay D. Fullman at (562) 694-6005 or jdfullman@mminternet.com.