STUART ADAMS
LAW OFFICE
A PROFESSIONAL SERVICE CORPORATION

BUSINESS START-UP TAX ISSUES

We are not tax attorneys and do not intend to offer any tax planning advice. We urge you, however, to meet with your accountant or tax planning advisor to ensure that all necessary tax filings and payment/withholding arrangements are made for your new company. If you do not currently have an accountant, please do not hesitate to call and ask for a referral.

The foregoing notwithstanding, there are a number of federal, state and local taxation issues inherent in starting up a new company. Some of these can have major financial and strategic advantages or disadvantages for both the newly formed legal entity, and for the owners and employees of the company. A few, but certainly far from all, are mentioned below.

Employer Identification Number

Filing for and obtaining your company's Employer Identification Number (which may be done online for some but not all types of entities) and, applying for "S" Corporation status (if available and desired) are just some of the first steps. At a minimum, there are additional required filings at the state and local level.

Self Employment Tax

Recent federal court decisions regarding self-employment taxes and withholding issues make it imperative that you deal with these taxation issues early in the life of the business. As an example, in a relatively recent case, sole and majority owners of "S" Corporations who performed substantial services on behalf of the business were taking draws from the company to pay for personal expenses, instead of classifying themselves as employees, thus attempting to avoid employment taxes. A federal appeals court ruled that the shareholders' actions were improper, and they were forced to pay back employment taxes, plus penalties and interest. This case has implications for both corporations and limited liability companies.

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Entity Classification Election

Several years ago the IRS developed a “disregard the entity” rule for one person companies, including LLCs. For most purposes, an LLC or “S” corp is treated just like a standard version of such an entity type (ex. liability). For tax purposes, however, the IRS may treat the equity owner of a one person LLC or S corp differently than the owners of the same type of entity with more than one member or shareholder, respectively.

If a company is formed under state law as a corporation (either S or C), it may not elect to be treated as any other form of entity. Entities with more than one member may, in some cases, use the IRS “check the box” form 8832, Entity Classification Election, to elect to be treated as a partnership or corporation for tax purposes. (IRS Code section 301.7701-3)

Resources

This is a complicated area and can be an expensive minefield for those who don’t pay attention. For more information, check out publications, such as the IRS Publication 334, Tax Guide for Small Business.