

When Do You Have to Incorporate and What is Involved?

Incorporation is one of any number of ways to structure a business. These include a limited liability company, an S-corporation and a C-corporation. Each structure has benefits and drawbacks, and it is important to decide which type of corporation works best for your situation, or if it makes sense to consider other options like operating without a corporation or working through an umbrella company. Understanding the options, however, is always a good place to start.

A limited liability company, or LLC, can be very beneficial for small businesses or single person enterprises. The paperwork involved in establishing an LLC is much less extensive than either an S-corp or a C-corp. Requirements differ from state to state, but an LLC does not require stock to be issued or a board of directors.

An S-corp is a smaller corporation that has a limited number of shareholders. One of the main benefits of an S-corp is that the profits from the company pass through the corporation to the partners. The partners pay taxes on the profits of the company on their personal income tax.

A C-corp has no limits on size or type of shareholders. Any company that properly fills out the paperwork for incorporation and pays the incorporation fee can become a C-corp. A drawback of C-corps is that the business profits are taxed, and then the profits are paid to shareholders are taxed again. This leads many people to feel that C-corps suffer from double taxation.

An umbrella company is a type of firm, sometimes called an employer of record, that provides a business infrastructure for you and is the legal entity you contract with clients through. The advantages of this type of situation vary by provider, but typically involve coverage under the group business insurances, simplified tax filing, access to benefits, and more. Legally speaking, under this type of arrangement you typically become a W-2 employee of the firm, however for operational purposes you still function like an independent contractor or consultant.

What are the Benefits of Incorporation?

There are a variety of reasons that a company would benefit from structuring itself as a corporation. The liability for the individual is reduced. Because a corporation sets the business apart from the individuals involved in the business, the partners are shielded from lawsuits and their personal assets are protected.

Another reason that someone may choose to incorporate is to reduce their tax burden. The structure of a corporation makes it much easier to track profits and losses and deduct business expenses. This reduces the tax that the partners must pay.

While it is difficult for many sole proprietorships to receive funding, a corporation, even if it consists of the same people, has a much easier time receiving money from investors or lending institutions. From another financial standpoint, a business that runs as a sole proprietorship is nearly impossible to sell, while a corporation is much easier.

How to Incorporate

Incorporating your business is not complicated, but the requirements vary from state to state and the paperwork can be time consuming. While it is very possible to incorporate by yourself, there are also many services available that will complete the corporation paperwork for you for a fee. Many lawyers will also complete the corporation process for you.

If you decide to complete the corporation process yourself, there are several steps that you must complete. Because the exact requirements differ from state to state, it is important to check the website of your secretary of state to get the details. Many secretaries of states' websites will also include all of the necessary forms that you can download from your computer.

Also, to begin the incorporation process you will need to choose a business name. The first step is perhaps the most simple; the next can be more complicated. You need to determine what type of structure you want your company to have. All three types of corporations, LLC, S-corp and C-corp have benefits and drawbacks. You will have to decide what type works best for your company. If you decide on an S-corp or C-corp, you will need to name a board of directors, which will need to be added to the bylaws, another necessity of incorporation. If you are establishing a C-corp or S-corp, you have to determine how you will issue shares of the company. Once you file your paperwork and pay the incorporation fee, you will receive your certificate of incorporation.

The process of incorporation can be extensive, depending on how much paperwork you have to compile. If you already have informal bylaws, and know who will be sitting on your board, the process can be relatively straightforward, with some help from the state's secretary of state office. If you are starting a new business and have no partners or bylaws, you may find it easier to hire an attorney to establish your corporation for you.

Other Options

Given the benefits stated above, it is not surprising that many individuals want to incorporate their business. However, the process can be long and filled with red tape, and maintaining the corporation on an ongoing basis means a bit of extra work. Depending on the situation, if an individual is self-employed as a professional consultant or freelancer, they can consider working with a portable employer of record or umbrella company. In this situation, workers can remain independent in their practice but can also enjoy the benefits of W-2 employment. Most employers of record offer everything from access to group health insurance to general liability insurance.

No matter what direction you wish to take your business, be sure to get all the facts. Often, individuals take the path of least resistance or go after too much, too soon. In the business world there is no telling what achievements or obstacles lay around the corner. Knowing all of your options is your first line of defense.

About the Author

Stephanie Larkin is a freelance writer who writes about topics pertaining to management, employment opportunities and [Back Office Operations](#)

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