# I'm a Small Business Owner: Should I Have an LLC or a Corporation?

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Good question! Most small business owners begin with no entity at all - just a sole proprietership or a DBA (doing business as). At some point, your business grows to the point where you are entering into contracts or creating products and exposing yourself (and your family) to the risk of personal liability. You heard from a friend: "You've got to set up an LLC" or "I have a Corporation for my business" and you begin to wonder 1) What's the difference? and 2) Which is best for my business?

# North Carolina LLC versus Corporation

## 1. North Carolina Limited Liability Company

In North Carolina, LLC's (limited liability companies) provide limited liability to its members while also allowing for a flexible tax and management structure. While not exactly a silver bullet for all business owners, it is a preferred entity type for solopreneurs (solo owners who where all hats) because of its flexibility. LLC's can be managed by one person, multiple people, or a third-party manager.

LLC's are considered a flow-through tax entity, meaning the business itself is not taxed on income, the income and tax liability are passed down to the individual members. You also have the flexibility of electing to be taxed as a partnership, a C-Corporation, or an S-Corporiation, allowing for the best possible tax outcome for your business. LLC's also allow the individual members to distribute profits and losses in whichever manner they see fit.

LLC's also have limited liability - meaning the personal assets of the members cannot be attacked by creditors, the LLC's assets are the only ones exposed. So, your personal liability is limited to your investment in the company. Your personal house, car, bank account, etc. cannot be taken by a creditor as long as you follow the normal corporate formalities of an LLC.

There are some small disadvantages to an LLC: 1) there are reduced opportunities to offer fringe benefits to owner-employees (i.e., pre-tax health insurance and 401k plans); 2) you cannot offer stock to your employees as incentive programs because you don't have stock - LLC's have membership interests which are expresses as percentages rather than shares of stock.

## 2. North Carolina Corporations

Corporations, like LLC's, have limited liability protection for their shareholders. Corporations come in two varieties: 1) C-Corporations ("C-Corp") and 2) S-Corporations ("S-Corp"). Both are completely separate entities with their own EINs, and both file tax returns. The difference is primarily based in tax treatment and investment opportunities.

### S-Corps

S-Corps are pass-through tax entities, much like an LLC, and so income tax is paid at the shareholder level rather than at the business level. The S-Corp files an "information return" with the IRS and NC Dept. of Revenue, but any net income is distributed to the shareholders and is claimed as income on their own personal returns. S-Corps also allow for the creation of tax-advantaged benefit programs ("fringe benefits") like employer health plans, 401k plans, etc. However, income and losses are attributed to each shareholder according to their ownership - unlike LLCs.

The number of shareholders in an S-Corp are also capped at 100, meaning an IPO or large scale solicitation of investors is impossible. So, you don't normally see S-Corps in your everyday life - they are more commonly found in small business and holding companies.

**C-Corps**

C-Corps pay their own taxes and can solicit unlimited investors. What they means is C-Corps are "double-taxed" entites, meaning the company pays corporate income tax on corporate income, and the shareholders pay individual income tax on the distribution of net income. C-Corps do not, however, pass losses on to shareholders. C-Corps can, however solicit large scale investments and offer publicly traded stock. So, C-Corps are meant for large companies or those expecting substantial growth. S-Corps are meant for small companies who want to benefit from the tax flexibility and don't anticipate much growth or outside investment.

## Which is Best for Me?

Short answer: It depends. There is no one-size-fits-all corporate entity. You need to take a long, hard look at your business as it is currently situated, but also where you expect it to be in the next 10-20 years. Flexibility is beneficial for small businesses, but sometimes flexibility needs to be sacrificed for long-term growth.

Interested in learning more? Contact us to speak with a Business Lawyer.