

BALANCING THE COSTS OF INCORPORATION AGAINST THE BENEFITS OF LIMITED LIABILITY

Costs of Incorporation. The costs of incorporation include miscellaneous fees of about \$300.00, plus attorney and accountant fees. In addition, each year there are \$825.00 in Franchise taxes and Secretary of State fees. Sole proprietorships do not have to incur these costs and fees.

Financial Benefits of Incorporation. One financial benefit is that with an S Corporation, if the reasonable compensation is paid to the owner, the remaining compensation is not subject to self-employment taxes. With a sole proprietorship all compensation up to \$102,000 is subject to self-employment taxes, and then the tax rate is 2.9%.

Benefits of Limited Liability. Owners of sole proprietorships or partnerships are completely responsible for all business debts. This means that if a judgment is rendered against the business for an unpaid contract or for a wrongful act by an employee or agent of the sole proprietorship, the business owner's house, investments, and other assets can be seized and used to pay the judgment.

Upon incorporation, there are limitations on the liability of the business owner. Unless the shareholder is personally involved in a wrongful act, the owner of a corporation is not personally responsible for the corporation's contracts or the wrongful acts of employees or agents of the corporation.

It is also important to consider that in difficult economic times litigation often increases, as businesses fail to pay their debts, and as failing businesses bring lawsuits in hopes of recovering money. For that reason, it may be prudent to incorporate to reduce the chance of being targeted with litigation.

Insurance. Both corporations and sole proprietorships can obtain insurance to reduce their liabilities. The kinds of insurance that can be helpful in many cases are business liability insurance, errors and omissions insurance, officers and directors insurance, employment practices insurance, workers compensation insurance, umbrella liability insurance, and even home owners insurance. However, most liability insurance has a deductible, as well as a liability limit. In addition, many liability insurance policies limit the amount of attorneys fees that are covered by the policies. As a result, even if a business owner wins the case, he or she may have to pay substantial attorneys fees. If the business owner loses the case, the insurance will not cover the deductible or the amount of any judgment in excess of the coverage limits. In addition, it is not uncommon for insurance companies to either deny coverage or to defend the insured under a "reservation of rights" under which the insurance company reserves the right to deny coverage at the end of the case. This means that the business owner may need to hire personal legal counsel to protect him or herself from the insurance company's denial. As a result, various kinds of liability insurance can be helpful but are certainly not a guarantee against a financial catastrophe for the business owner.

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