CONSULTING TIP OF THE MONTH
TO INCORPORATE OR NOT TO INCORPORATE, THAT IS THE QUESTION
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A threshold legal question the consultant must answer before commencing operations is whether to conduct business as a sole proprietor (with or without a fictitious name) or as a legal entity of one sort or another. For a solo consultant, the entity choices are corporation (C or S corporation) and limited liability company. For two or more consultants in business together, add limited and general partnerships. The critical considerations in selecting one of these entities are (a) limitation of liability (of the consultant personally and his/her business) and (b) tax implications.

Liability: A consultant who conducts business as a sole proprietor or in general partnership with other consultants generally has unlimited contractual and tort liability for personal or property damage of any description suffered by a client. With or without the additional protection of a limited liability entity, the consultant will want to have the full range of insurance protection – property and casualty, general liability, professional errors and omissions, and possibly others (unemployment compensation for employees, disability, medical, life, etc.). A corporation, limited liability company, or limited partnership adds another layer of liability protection beyond that provided by insurance: by law, the entity's and owner's liability is limited to the entity's net assets (plus any assets distributed while the entity was or was becoming insolvent). Forming such entities, however, is not costless: there are state filing fees, likely some legal and possibly accounting costs, additional ongoing record-keeping, and respect of the relevant legal formalities (e.g., not commingling personal and business assets). If contractual insurance coverage seems adequate – at least at the initial stages of business – the additional cost in dollars and learning time to form an entity may not warrant the additional theoretical layer of protection. As the business grows, this assessment may change.

Taxes: The other major factor to consider in determining whether to operate as a sole proprietor or general partners or as a limited liability entity ("LLE") is taxation, both income and employment. Only a C corporation is a taxable entity separate from its owner(s); all other LLEs are "pass-through" entities taxwise, mere conduits for the passing of tax consequences through to the owners. In certain circumstances, a C corporation that converts to S status can carry its separate taxability into the S regime for a period of years; but in all other cases, only the owners pay tax on entity income. But all businesses, with or without a LLE, may also be liable for self-employment tax of one or more owners and employment tax for employees. "Employment tax" refers to Social Security and Medicare withholding; employers of any legal form must also withhold income taxes on employee wages.

Conclusion: For many consultants, operating alone or with partners, the best legal form in which to operate is the limited liability company: it limits owner liability to the owner's unreturned investment in the entity, one level of taxation (by contrast with a C corporation), and maximum entity asset protection from creditors of owners (since

they can generally not compel distributions or lay claim to anything other than actual distributions, if any, made by the entity). But before even this attractive compromise is selected, the consultant should be certain that any entity at all is really needed.

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Mr. DeLaurentis will speak on this topic at the October meeting of the Chemical Consultants Network. Click here for details.

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