

SHOULD YOU FORM AN LLC?

The initials “LLC” are appearing more and more frequently after company names in the Milwaukee Business Journal, which lists new company formations, the percentage is approaching 50%. The initials stand for Limited Liability Company, a recognized legal type of business organization, formed through the Department of Financial Institutions.

Owners of LLC’s, called members, can operate the business without the possibility of being held personally responsible for the debts and obligations of the business in the event of failure. This feature, similar to that of shareholders of a corporation, seems to be the primary reason for the popularity of LLC’s. Comparisons have been drawn with partnerships, but a regular partnership, no matter how many limited partners there are (who are shielded from personal responsibility, but generally do not take part in the management of the business), must have at least one partner who is liable without limitation.

Being a member in an LLC does not eliminate the need to pay self-employment taxes. Members who actively run the business must pay the self-employment tax on their share of the LLC’s earnings. This tax presently (2007) is 12.4% as the Social Security portion on earnings up to \$84,900, and 2.9% as the Medicare portion with no ceiling. This totals to 15.3%, which is the same as the percentage paid in for employees. BUT in the case of employees, half is paid by the employee and half by the employer. In general, half of the self-employment tax paid is tax deductible. If they meet IRS requirements, LLC members who do not actively participate in the operation of the business, do not have to pay the self-employment tax.

But for all the pros in forming a LLC, there are some cons. Here are the two that must be considered. First, wholesalers know that the probable reason for forming an LLC is to avoid personal responsibility. They may require cash on delivery (COD) for their goods and services, which will tighten up the money supply at a time when it is most critical—the start-up period. Secondly, borrowing money will be made more difficult for the same reason, and if a loan application is approved by a lender, a personal signature may be required, effectively removing the non-personal responsibility feature. Also, under SBA regulations, anyone owning 20% or more of a business must be personally responsible for debts and obligations. So, consider all factors before making a decision to start an LLC.