

# 3

MODULE THREE

# FORM

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At this point we have collectively gone through all the core background info we need in Module 1. In Module 2, some of you worked on taking steps to unfuck some stuff in your business.

You may still be working through the tasks in Module 2. For example, OICs can take 6-12 months. That's totally ok.

But now, we all get to come together in Modules 3-5 to fully setup our business correctly. Yay! In this module, we will focus primarily on the legal formation aspects. By the end of Module 3 your should have your LLC or s corp formed, your business licenses, including tax certificates, EINs, seller's permits, and dbas up to date.

We will also discuss payroll, insurance, operating agreements, and meeting minutes. These are a few of the things that often get overlooked in the formation process.

The focus on the module videos will be on **WHAT** you need to do and **WHEN**. At the end of the module, you'll create your action plan of all the things you need to get done.

Then, check the tutorial vault for step-by-step videos on how to tackle certain tasks.

# CHOOSING YOUR ENTITY

*Most of the info you need on business entities, we covered by in Module 1. If you need a refresher, hop back there. In this lesson, we will rehash the basics, and you will decided which entity choice is right for you.*

Business entity is legal jargon for the different ways to legally form and organize your business. The typical options are sole proprietorships, general partnerships, limited liability companies (LLCs), s corporation, and c corporations. There are some other less common options as well. In this lesson, we will discuss each of these, and then you will choose which is right for you.

The "default entities" are the sole proprietorship and general partnership. As noted in my video, I advise everyone to choose an entity that is NOT a default entity. Typically, cost is the only reason you would choose not to form a different entity.

The most common options for small business owners are LLCs and S Corps. Remember, an S Corp is not an entity. It's a tax status. Therefore, most of us in LL, an LLC would be the best starting point. If you plan to make more than \$60,000ish this year, complete my s corp worksheet to see if you should consider that option.

This course is not designed for C Corps, so no one here should be in that boat. Other entity options include the B Corp and 501(c)(3), which are more appropriate for those with more philanthropic goals. Also remember that, professional license holders like CPAs, lawyers, and doctors may be limited in their options. Many states require them to form professional corporations or limited liability partnerships (LLPs).

## A QUICK S CORP RECAP

There are two time requirements. If you want to have S corp status in the first year of your business entity, meaning in the first year you form your LLC, you must file for S status within two months and 15 days from the date of forming your business. For existing entities, you can change to an S corp by filing by March 15th.

S corps save you from paying self-employment tax (Medicare and social security) on the portion of income that you do not pay yourself as salary. BUT remember that salary must be reasonable.

### ***What are the limitations***

Estates, trusts, and certain tax-exempt organization cannot be s corps. S corps are also restricted to one class of stock and a maximum of 100 shareholders.

There are also special rules for profit and loss allocation. Most likely, if you're in Legally Launched, these are non-issues, as I recommend individuals with these considerations to work directly with an attorney.

### **HOW TO MAKE YOUR DECISION**

You may likely already know which entity is best for you, but if you're not quite there, start with the risk assessment guide to help decided if you want to go for the LLC. Then, you can go through the s corp guide for a better picture of if you're ready for that.



GUIDE

# LIABILITY ASSESSMENT GUIDE

*Use this guide to help make your decision as to whether to you want to form an LLC.*

Please, please note that liability is not an exact science and that risk is always relative. You may have little worries with regard to risk, or feel comfortable with your insurance and contracts.

The idea of this assessment is to illuminate some of the areas where there are risk.

# LIABILITY ASSESSMENT GUIDE

What's your risk?

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**01. Location**

Do you have a store-front, venue, or other location that's not just an off-site office?

**02. Partners**

Do you have 1 or more business partners?

**03. Hands on**

Do you operate a hands-on business (like massage, physical therapy, or salon type services)?

**04. Injuries**

Does your business involve a risk of harm to client or customers? Think personal training and the like

**05. Employees**

Do or will you have any employees?

**06. Contractors**

Does your business model rely on independent contractors?

**07. Contracts**

Do or will you sign contracts valued at, near, or over \$5,000.

**Tally your score.** Questions 1-5 are 3 points each if you answered yes. Question 6 is two points, and question 7 is 1.

**WHAT'S YOUR TOTAL?**

# LIABILITY ASSESSMENT GUIDE

What's your risk?

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## ***Assessment Explanation***

My opinion. An LLC is great for everyone. It's never a bad idea. The question is really whether you want to spend the money to form it.

In California the cost of an LLC is \$800 per year plus a \$70 filing fee. If you answered "yes" to any of the questions numbered 1-5 above, I would consider doing what you have to do to form your LLC before taking on clients. Having employees, working in a physical capacity with clients, and operating a storefront all open you up to risk.

Curious why having a business partner is a 3-pointer? Partnerships are subject to joint and several liability. That means if one partner does something to put the business at risk, both partners' personal assets are on the hook.

If you only scored 1 or 2 points (or if you got 3 points by answered "yes" to the last three questions, an LLC is definitely recommended, but you would probably be in the minority by having one. What does this mean? I wouldn't too paralyzed by fear to go ahead and start taking clients and making money. But keep the LLC in mind for whenever the cost seems doable.

If you scored 0, but guidance remains the same. An LLC is still not a bad idea, but you likely have a very low risk business model and should feel comfortable taking clients.

## ***The Layers of Protection***

Remember that the LLC is just 1 of the 3 layers of protection. You also want to protect yourself with solid contracts and good insurance.



GUIDE

# S CORP DECISION GUIDE

*Use this guide to help make your decision as to whether to elect s corp status.*

It's simple enough to read the generalizations in this text and in others, but we want to actually apply that to your business and your current level of income. Use this guide to help you determine if you're s corp ready. If the answer is no, then keep it handy for next year. If you're not read then, try again the next year.

# S CORP DECISION GUIDE

Are you s corp ready?

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STEP 1	ANTICIPATED NET BIZ INCOME THIS YEAR	
STEP 2	WHAT'S YOUR REASONABLE SALARY	
IF BOX 1 IS LESS THAN \$137,000 GO TO STEP 3. IF NOT, STEP 5		
STEP 3	SUBTRACT BOX 2 FROM BOX 1	
STEP 4	MULTIPLY BOX 3 BY 0.153	
STEP 5	SUBTRACT \$137,700 FROM BOX 1	
STEP 6	MULTIPLY BOX 5 BY 0.029	
STEP 7	SUBTRACT BOX 2 FROM \$137,700	
STEP 8	MULTIPLY BOX 7 BY 0.0153	
STEP 9	ADD BOX 9 TO BOX 6	

Your total from box 8 or 4 represents a rough estimate of how much you could save by filing for s corp status. On the next page, we will break down potential, added costs to decide whether the savings would be worthwhile.

**Please Note:** these calculations provide a very rough approximation of whether you would save from an S corp. Also, you need to do an alternative calculation if your "reasonable salary" would be greater than \$128,000.

The purpose of this exercise is two-fold. It should give a rough idea of how an S corp can save, and simply provide guidance as to whether it's worth your time to seek a professional opinion on whether an s corp may be right for your business.

# S CORP DECISION GUIDE

Are you s corp ready?

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STEP 10	PUT HERE YOUR TOTAL FROM 9 OR 4	
STEP 11	HOW MUCH WILL PAYROLL COST	
STEP 12	COST FOR OUTSOURCED BOOKKEEPING	
STEP 13	ADD BOXES 11 & 12	
STEP 14	DIFFERENCE BETWEEN 9 & 13	

**You did it!** Box 13 is your estimation on how much you could save from making an S election. Remember, this is a rough estimation. If you want more specifics, you can always consult a pro 1-on-1.

My rule of thumb is that if your box 13 is at least \$1,000 you should go for it. Keep in mind that if you do hire a bookkeeper, you can now offset that cost with what you're saving on taxes. That also frees up your own time to focus on other revenue generating activities.

Also note other than the payroll cost, there's no downside to an S corp. So even if you do it a little too early, it shouldn't cost you anything additional.

### **Step 3**

Do some research on what the average salary is for someone in your geographic area, in your industry, with your level of experience. Check a handful of sources and average the averages. This isn't an exact science. Remember that the lower the salary you give yourself the more you save in tax, but also the more risk you have in an audit. Thus, you want to find your best approximation of a truly reasonable salary. Then, substantiate that with evidence and reasoning.

### ***Why there are two different paths***

Remember back to the self-employment section in Module 1 that after net business income exceeds \$137,700 (the figure for 2020), you no longer pay into social security, just Medicare. Thus, the self-employment tax goes from 15.3% to 2.9%.

### **Payroll Costs**

Some tax accountants and CPAs can run payroll for you. If you already have a tax pro, check with them on their cost. Otherwise, I'm an affiliate and big proponent of Gusto Payroll. Their cost is \$40ish per month plus around \$5 for each additional person on payroll. We will cover payroll specifics later in this module, but you can use these numbers as a placeholder.

### **Bookkeeping Costs**

Outsourcing your books is not a must, BUT since there's a little more risk associated with s corps, it's important to really get your shit together if it's not already. If you're not confident that you can keep everything tidy on your own, then I highly recommend outsourcing your books. I'm an affiliate for Bench Accounting. They run around \$150 a month and are a great option to save some money and get basic helps with your books. If you have a lot of transactions, want higher level guidance, and want someone with whom you can have regular conversations, a dedicated bookkeeper is what you need. Expect to pay around \$300 a month. Let me know if you want a referral.

**CHECK OUT BENCH**

*I do earn affiliate commissions from Bench. We can chat if it'd be a good fit for you. If you decided yes, I'd love it if you went through my affiliate link. :D*

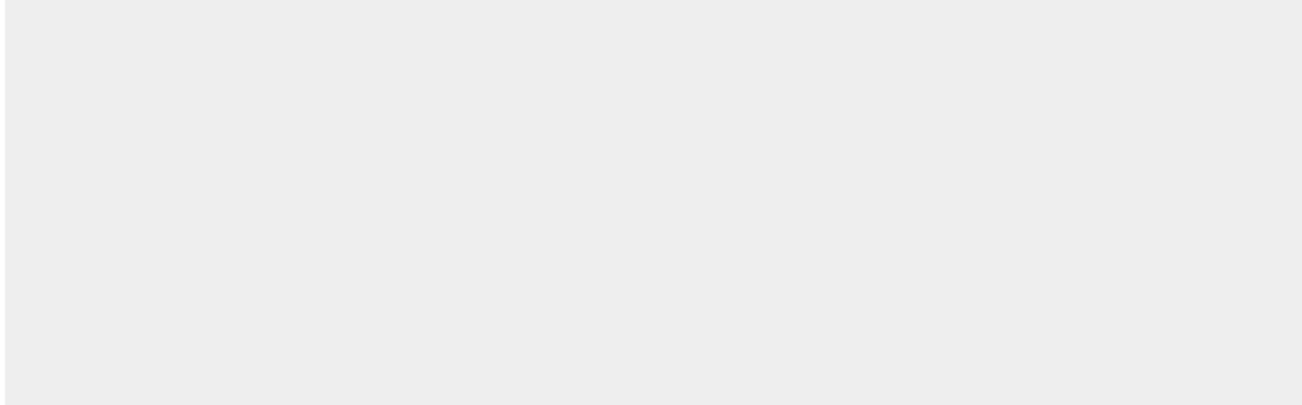
# EXAMPLE

Assume Tess has net business income of \$150,000. Follow the steps to determine how much she could save with an s corp assuming she decided to pay \$50/month for payroll and \$300/month to hire her first bookkeeper. Assume her reasonable salary is \$65,000.

<b>STEP 1</b>	<b>ANTICIPATED NET BIZ INCOME THIS YEAR</b>	<b>\$150,000</b>
<b>STEP 2</b>	<b>WHAT'S YOUR REASONABLE SALARY</b>	<b>\$65,000</b>
<b>IF BOX 1 IS LESS THAN \$137,000 GO TO STEP 3. IF NOT, STEP 5</b>		
<b>STEP 3</b>	<b>SUBTRACT BOX 2 FROM BOX 1</b>	
<b>STEP 4</b>	<b>MULTIPLY BOX 3 BY 0.153</b>	
<b>STEP 5</b>	<b>SUBTRACT \$137,700 FROM BOX 1</b>	<b>\$12,300</b>
<b>STEP 6</b>	<b>MULTIPLY BOX 5 BY 0.029</b>	<b>\$357</b>
<b>STEP 7</b>	<b>SUBTRACT BOX 2 FROM \$137,700</b>	<b>\$72,700</b>
<b>STEP 8</b>	<b>MULTIPLY BOX 7 BY 0.153</b>	<b>\$11,123</b>
<b>STEP 9</b>	<b>ADD BOX 9 TO BOX 6</b>	<b>\$11,480</b>
<b>STEP 10</b>	<b>PUT HERE YOUR TOTAL FROM 9 OR 4</b>	<b>\$11,480</b>
<b>STEP 11</b>	<b>HOW MUCH WILL PAYROLL COST</b>	<b>\$600</b>
<b>STEP 12</b>	<b>COST FOR OUTSOURCED BOOKKEEPING</b>	<b>\$3,600</b>
<b>STEP 13</b>	<b>ADD BOXES 11 &amp; 12</b>	<b>\$4,200</b>
<b>STEP 14</b>	<b>DIFFERENCE BETWEEN 9 &amp; 13</b>	<b>\$7,280</b>

## SO WHAT WILL IT BE

Write in the box what entity you're going with. Will you stick with the sole prop, go for an LLC, or file and LLC to be taxed as an s corp?



## NOTES

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*Still not positive which option is the best option for you? Don't sweat it. Let's talk about it on a Q&A*