

AKD Consultants
Adam Dworkin
CPA
188 Whiting Street
Suite 10
Hingham, MA 02043
781-556-5554
Adam@AKDConsultants.com

Should I incorporate my business?





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Question:

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Answer:

Operating as a sole proprietor is often the simplest and least expensive way to organize your business. Even so, many business owners choose to incorporate their businesses. But taking that step has both advantages and drawbacks.

A chief advantage of incorporation is that the business assets of the corporation can be separated from your personal finances. As a result, your personal assets generally can be shielded from creditors of the business if you incorporate your business.

To maintain this legal separation (known as the corporate veil), you must observe certain formalities. For instance, you must keep corporate assets separate from personal assets, hold periodic shareholder meetings, and file reports required by various government agencies, including a separate tax return. The costs of establishing and maintaining corporate formalities are a disadvantage of incorporation and must be factored into your decision.

Another possible disadvantage of incorporation is double taxation of income. Double taxation means that after the corporation pays tax on its earnings, you must pay tax on corporate earnings distributed to you as dividends by the corporation. In many instances, corporations with 100 or fewer shareholders can avoid double taxation by electing to be treated as S corporations.

Before deciding to incorporate, you should seek legal and tax advice on what type of ownership best suits your business. Other forms of ownership may offer your company the advantages of incorporation (such as limited liability), but also offer more management flexibility or tax advantages. You might also want to consider how big you expect the business to grow, and the sources of financing you expect to tap. An experienced attorney and tax advisor can help you decide which form of ownership is best for your business.

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