

Chicago Music Commission: Music at Work Forum **“Setting Up Your Music Business”**

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Why create a company?

The main reason most people start a company, is to make money. A way to receive a steady income stream from a source that they control, in an industry that the person is very familiar with or has a particular talent in, and under circumstances where they can name the location and hours that fit with their lifestyle.

A lot of time, energy and planning goes into every aspect of the business to ensure its profitability, but the areas often overlooked in the creation process are the tax and legal implications of the startup decisions.

Why is tax and legal planning important?

Two main functions a company offers its owners are legal liability protection and tax savings. A company functioning as a sole proprietor loses both of these benefits.

Legal protection: Only available to a company that is created separate from the owners, and only if the owners are operating the business ‘as a business’. (Pierce the Corporate Veil.)

Tax savings: Certain benefits and tax savings are available to companies that are not available to sole proprietors. Sole proprietors pay the maximum tax possible on earnings and profits.

What are the different entity types?

Sole Proprietor: A company created without any legal paperwork. The owner does not get a salary, but 100% of the profits (and the tax responsibility) belong to the owner.

- Can be created by anyone
- No cost to create the company
- Income and expenses are reported on a Schedule C on the owners personal Form 1040 return
- SE tax paid on 100% of the profits

LLC/Series LLC: A company created with one or more individuals, where the profits flow through to the owners and tax is paid on the profits. In these types of entities, owners generally do not get a salary, but take distributions from accumulated earnings instead.

- Created with “Articles of Organization”
- No limitations on the number of members or partners
- No limitations on citizenship of the members or partners
- Profits and distributions can be unequal
- Most expensive entity type to create and maintain
- SE tax paid on 100% of the profits
- Income and expenses are reported on a Form 1065 Return, with the owners respective share reported on a K-1 that flows through to his personal Form 1040 return. (Single Member LLCs report income on a Schedule C just like a sole proprietor.)

S-Corporation: A company created with one or more individuals, where the profits flow through to the owners, and a limited amount of tax is paid on the profits. Earnings are distributed via payroll or distributions.

- Created with “Articles of Incorporation”
- Limited to 100 shareholders (family units count as one)
- A foreign citizen cannot be a shareholder
- Profits are distributed based on ownership percentages, and must be equal
- “Reasonable salaries” must be paid to Officers
- Less expensive entity type to create and maintain
- No SE tax paid on the profits, 1.5% Replacement Tax paid on profits
- Income and expenses are reported on a Form 1120S return, with the owners respective share reported on a K-1 that flows through to his personal Form 1040 return.

C-Corporation: An entity where profits remain in the company, and do not flow directly to the owners. Profits are distributed through payroll or dividends, and there is “double taxation” on dividends paid.

- Created with “Articles of Incorporation”
- No limit to the number of shareholders
- A foreign citizen can be a shareholder
- Profits are distributed via dividends paid to shareholders (“Double Taxation”)
- Salaries must be paid to Officers
- Less expensive entity type to create and maintain
- Income and expenses are reported on a Form 1120 return, and corporate tax rates apply

What resources exist to help with creating a company?

For the most part, the Internet supplies all of the tools needed for someone to create a company without the assistance of an attorney or an accountant. Many websites have instructions on what forms to fill out and where to submit them, and some helpful sites are:

- Internal Revenue Service (www.irs.gov)
- Illinois Department of Revenue (www.revenue.state.il.us)
- City of Chicago (www.egov.cityofchicago.org)
- Secretary of State (www.cyberdriveillinois.com)

In spite of this wonderful resource, the creation of a company is a complicated process with many documents and forms. It is very easy to fill a form out incorrectly, or omit a form inadvertently, and often times it costs more in time and money to fix a problem than it would have cost to pay someone to do it in the first place.

What information do I need to start a company?

While some business owners do not want to create a company without first drawing up a full business plan, others jump right in without a second thought. Start up requirements are varied, and are dependent on the type and size of business that is being created, as well as the comfort level of the company owners themselves.

From a legal perspective, however, there are a handful of questions that need to be answered in order to create a company:

- What is the name of the business?
- What is the purpose of the business?
- What type of entity structure will the business have?
- Who will the owners, managers, shareholders be?
- Who will the officers be?
- How will the profits and losses be distributed among the owners?
- How many shares will be authorized and issued?
- Who will the registered agent be?
- What will be the fiscal year end? (generally a calendar year)

What documents are needed to create a company?

There are two main sets of documents needed to fully register a business. One set all companies generally have. The other, all companies SHOULD have, but many don't.

Necessary Documents and Information (Federal registrations):

- Articles of Incorporation or Organization with a Deed Stamp (stamp often missing)
- Shareholders Agreement (if more than one owner)
- EIN number
- Form 2553 for an S-Corporation (subchapter S election form – must be filed within 75 days of incorporating)

Additional Documents (often missing)

- REG-1 (registration with the State of Illinois: income tax, payroll and sales tax)
- UI-1 (registration with the Illinois Department of Employment Security (IDES): state unemployment)
- UI-1 S&P (IDES successor business determination application)
- Newhire forms with IDES (must be filed within 20 days of hiring an employee)
- City Business License

How long does it take?

There are two options when submitting the Articles of Incorporation/Organization to the Secretary of State: regular processing and expedited processing. With expedited service an additional fee is paid, but the documents are returned within 24-48 hours. (For someone who wants to start a company quickly, this is definitely the option to choose.) For an owner that can wait, regular processing generally takes between 4-6 weeks.

Once the approved Articles are received, an EIN number can be obtained online in a matter of minutes, and a company can be up and running immediately. The remainder of the paperwork can be completed after the company is in business, however there are filing deadlines to be aware of:

- Form 2553 must be submitted within 75 days of the date the Articles were approved.
- Forms REG-1 and UI-1 must be submitted within 30 days of the date the Articles were approved.
- Newhire Forms must be filed with IDES within 20 days of hiring an employee

How much does it cost to create a company?

The cost is dependent on how much of the work a company owner wants to do themselves, how quickly they need the company created, whether some or all of the incorporation documents are filled out, and whether they use an accountant/attorney or both to do the paperwork. Each step has a different price attached, and every legal and accounting professional will have his or her own fee schedule.