THE NEVADA EDGE

5TH EDITION

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NCH

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Cort Christie has been helping entrepreneurs incorporate their business in Nevada for over 30 years. NCH was Cort's first company, started at the young age of 25. Playing into Cort's entrepreneurial passion, NCH is one of the largest incorporating and business service companies in America. NCH has helped over 80,000 new businesses achieve their dreams by providing bullet-proof business start-up support. In 1998, Cort was recognized by Ernest and Young as a winner of their coveted "Entrepreneur of the Year" award.

Over the years, Cort has served on boards of directors for organizations such as Nevada Policy Research Institute, Reno Entrepreneurs Organization, Nevada Registered Agent Association, Nevada Center for Entrepreneurship and Technology and Sage Ridge College Preparatory School. He's also an active member of the International Entrepreneur Organization and started Las Vegas' first chapter, which currently has over 50 members, in 1999.

Cort speaks at seminars and workshops on subjects such as Entrepreneurship, Asset Protection, Small Business Tax Strategies and Fundraising. He has also hosted his own business radio show and has appeared as a guest on hundreds of other radio and television shows throughout the country. As if that's not enough, Cort's written several books and publications for small businesses including *Incorporating in Nevada*, *The Nevada Edge*, *77 Ways of Raising Money for Your Business*, *The Insider's Guide to Building Business Credit* and the *Nevada Corporation Manua*l.

Cort splits his workdays between Las Vegas, where NCH is based, and Reno where NCH has a northern Nevada office. He makes his home in Reno, Nevada, where he spends his time skiing, motorcycling, mountain biking and hiking the Sierras with his family.

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Introduction

Economic uncertainties and booming litigation remain prevalent to this day. These economic realities continue to send a steady stream of entrepreneurs (individuals, families and businesses) to Nevada each year through incorporation in an effort to stabilize their financial situations. Nevada limited liability companies and corporations have provided the means for these insightful people to gain an edge on their future, as well as to provide needed privacy and protection today. The benefits of incorporating in the "Silver State" are known throughout the world.

Nevada adopted its Revised Statutes for corporations (which also encompass LLCs) in 1987. Their creation was based primarily on Delaware corporate statutes, which have attracted businesses from around the nation for the past century. A long-time pro-business state, Nevada was looking for new ways to increase its revenues without having to tax its citizens or businesses.

While the casino industry has always been the main source of tax revenue for the state, as Nevada continued to grow, the state sought additional ways to create revenue. As it turned out, providing businesses with favorable incorporating conditions proved to be a successful new source of revenue for the state and a new vehicle for the entrepreneur.

Nevada's corporate laws continue to attract entrepreneurs and businesses from around the world who are looking for an edge. That's because Nevada made its process for incorporating simple, inexpensive, and painless. Delaware and Nevada are comparable in that they both have quite favorable corporate statutes but Nevada looked at Delaware's statutes and took them one step further.

In Nevada, personal liability is determined by statute, not by the courts on a case-by-case basis. That means individuals are not subject to the standards applied by individual judges. By statute, personal liability for corporate actions is only considered in cases of fraud or manifest injustice, making Nevada the best state for owners and operators who want to protect their personal assets.

Nevada has also stuck to its guns in remaining a 'no-income-tax' state on behalf of its citizens and businesses. Whether you live in state or not, this is another significant attraction in favor of incorporating in Nevada, whether you live in or out of state.

Nevada embodies the Western free spirit. Gambling and gun-slinging are part of its culture. In general, Nevadans are independent people and believe that government should be kept small and out of people's lives as much as possible. It's no surprise then that the corporate culture created by Nevada embodies that credo. A Nevada corporation or LLC is given the same respect and status that every citizen of Nevada receives. Unlike courts in other states, Nevada's courts stick behind their LLCs and corporations to protect the rights of representatives to remain separate from corporate liability. This is vital seeing as many statutes in this country are now allowing lawsuits to 'pierce the corporate veil, making the officers and directors personally responsible for the debts and actions of a corporation or LLC.

Furthermore, since a corporation/LLC is deemed a “citizen” of the state in which it’s incorporated, these statutes are a crucial factor that courts will look to in determining what law to apply during litigation. (Other key factors include where the corporate activities occur, where money transactions take place, and choice of law provisions in contracts. In other words, formalities matter!)

Nevada corporations also attract people from around the country who are interested in protecting their personal assets and keeping their private lives as private as possible. Personal assets such as real estate, intellectual properties, cash and securities, can be owned by a corporation, providing further protection of assets that may be at risk. Remember, protecting your assets and yourself from personal liability is lawful when done well in advance of any known or anticipated litigation.

This guide to incorporating in Nevada was created with simplicity in mind, emphasizing the essential information you’ll need to start your LLC or corporation off on the right foot. The most critical step is making sure you cover all the bases and establish everything correctly from day one.

There’s nothing more empowering than realizing your ability to create an entity-- something that can help you build the life you’ve always wanted to live. It takes initiative to get ahead in business. So, take initiative today and get incorporated!

Chapter 1: WHY DO I NEED TO INCORPORATE?

There are two overriding reasons that should drive every entrepreneur to learn how to properly structure their businesses. One, the risk for entrepreneurs that taxes will be increased is a constant threat. Two, the countless lawsuits filed against small businesses every day.

Consider the cautionary tale Rich represents:

After college, Rich realized he wasn't happy and wasn't making enough money reporting to someone else every day. He had the future security of a new family to think about. So, he decided to venture out on his own and fulfill a dream that had been calling to him for as long as he can remember. Though he wasn't sure exactly how to go about structuring his business, Rich forged ahead anyway. In doing so, Rich missed many details that would later lead to his financial demise. He didn't foresee the lawsuit that would be filed against his business, or the personal responsibility he had failed to protect himself against in setting up his business. Those seemingly small missed details now threaten everything he's worked for, including the nest egg he had put away for his daughter's college education.

It's common for entrepreneurs like Rich, who haven't thought out how to structure their businesses to choose a sole proprietorship or a partnership. What these individuals fail to realize though are the long-term implications of starting their businesses without proper planning. They started their business as an individual and will now be personally responsible for any infraction or accident that involves that business.

Every entrepreneur should start their business venture as a separate business entity, like a corporation or limited liability company (LLC). If the business venture fails, the incorporated entity allows the entrepreneur to protect his or her personal assets and not carry losses over to the next business venture. Because honestly…have you ever met an entrepreneur with just one business idea?

The other issue many entrepreneurs face is deciding on the state in which they should establish their entity. Well, as mentioned in the introduction, Nevada has taken the lead as the state of choice for incorporating, thanks to the protection benefits it offers.

Why Incorporate?

Many people think that incorporating is not for them because their business consists of a single person or their family. Not so! Whatever its makeup, incorporation offers your business countless advantages!

For starters, a corporation is a legal entity created separately from those who own and operate it. That means that the corporation's debts and taxes are separate from its owners (shareholders), thereby offering the greatest personal liability protection of any business structure.

Why is personal liability protection important? There are many reasons, but consider this: Each year, hundreds of millions of dollars are awarded to employees of U.S. businesses each year in employment-related cases. In 1999, a jury rendered the largest award ever against a U.S. company in a consumer case – over $5 billion dollars – payable to the victims of a car crash.

In addition to liability protection, a corporation offers tremendous estate planning advantages because it continues to exist even after the death of a shareholder. Incorporating also offers attractive tax advantages, prestige, the road to better financing and the ability to raise cash. Corporations can be used to own real estate, automobiles, yachts, or aircraft, while also providing health and life insurance, retirement benefits and expense accounts.

Individual vs. Corporation

As individuals we earn money, pay taxes, and buy things. A corporation earns money, buys things, and then pays taxes. What would you rather do, pay for things with pre-tax or after-tax dollars?

The following illustration shows how an individual who has $60,000 per year in revenue can save close to $7,000 in taxes just by incorporating. The power of being able to determine what you pay for yourself and what stays in the corporation for future expenses of the company is what draws millions of people to incorporating rather than running their businesses as sole proprietorships or partnerships.

The illustration below doesn't consider several areas that would make the illustration even more compelling, such as retirement accounts, fringe benefits and state income taxes.

Independent Contractor
John Doe

Revenues	$60,000
Expenses	$10,000
Gross Profit	$50,000
Taxable Income	$38,375
Income Tax	$ 6,404
Self-Empl. Tax	$ 7,650
Total Taxes Paid	$14,054

Corporate Plan
John Doe, Inc.

Revenues	$60,000
Expenses	$10,000
Salaries Paid (includes ½ FICA)	$21,530
Gross Profit	$28,470
Corporate Tax	$ 4,270
Net Profit	$24,200
John's Income	$20,000
John's Taxable Income	$12,200
John's Income Tax	$ 1,480
John's ½ FICA	$ 1,530
Total Taxes Paid	$ 7,280

Liability Protection

Corporations are primarily used for liability protection and were created to limit the direct responsibility of the participants for the faults or debts of a business. An individual can invest money in a corporation, and that investor's potential loss will be limited to the amount of money invested and no more.

But while most small business owners know that incorporating can shield personal assets in the event of a frivolous lawsuit, many are lulled into complacency by an "it-won't-happen-to-me" attitude. This thinking has resulted in tremendous losses to many unprepared business owners. It's not hard to see why, given the statistics (from 2015):

- Over 15 million civil lawsuits are filed each year in the U.S.
- About 80 percent of all lawyers' worldwide live in the U.S.
- The U.S. has one lawyer for every 250 residents compared to, for example, Japan where there is only one lawyer for every 8,412 residents.
- There are now more than 1.3 million attorneys in the U.S.

In a litigious society, incorporating to protect yourself not only makes sense, it virtually is a necessity. No other structure gives you and your business the liability protection offered by a corporation. Most states have adopted statutes that limit the liability of corporate representatives, including officers, directors, and shareholders. This is great news because just like an individual, corporations can be sued, file for bankruptcy, and more, and in most cases, the personal assets of the owners are protected. So, as you can see, incorporating to protect yourself not only makes sense, it's necessary.

Unlike a sole proprietorship or partnership, a corporation can accumulate debt without ever making its officers, directors or stockholders responsible for the repayment of that debt. If a corporation gets itself into a lawsuit, the outcome of that lawsuit can affect the corporation directly, but the participants generally cannot be held responsible. Two notable exceptions to this rule exist. One, officers can be liable if corporate formalities have not been maintained. Two, liability can be passed on to the owners and officers in the case of fraudulent activity.

Because of the obvious advantages of limiting the amount of personal liability that one takes on by operating through a corporation, many strategies have been developed to protect the assets of businesses that have potential lawsuit risk. In addition, other strategies have been developed to protect the assets of individuals because of our litigation-crazy society.

Asset Protection

It doesn't take a catastrophic lawsuit to wipe out everything you own. Little things can affect a small business, leaving the owner's personal assets fully exposed.

For example:

- One or more of your largest customers could stop paying their bills or file for bankruptcy.
- New technology, competition, legislation or market conditions could render your product or service obsolete or significantly reduce demand.
- You could suddenly become incapacitated and unable to manage the business operations.

Could you satisfy all your business obligations without tapping into personal reserves or losing personal assets? Existing assets (bank accounts, homes, cars, etc.) are not the only targets for creditors.

Unrealized assets, such as future earnings, inheritances, and insurance settlements, are also at risk in the event of an unfavorable judgment.

Litigation

With lawsuits around every corner, you can easily find yourself in a financial crisis that could cost you most or all your assets. Each year, thousands of families are affected. Don't think for a second it couldn't happen to you! It's estimated that around roughly 50,000 new lawsuits are filed every day of the week.

No matter how safe and secure you feel today, you can never be certain that your lifetime accumulation of wealth won't suddenly disappear tomorrow. There are too many ways to get into financial trouble. You can be hit unexpectedly with:

- A lawsuit by business partners
- A professional malpractice lawsuit
- A major damage suit for injury around your home or business
- A tax audit and a large IRS assessment
- A costly uninsured motor vehicle accident
- Unanticipated medical bills
- A divorce
- A suit for defamation of character

The above examples are very real. Consider the alarming statistics below:

- According to researchers, there's a 48 percent chance you'll divorce. And that reflects nearly three-decades of *decline* in the divorce rate.
- According to the U.S. Census Bureau, 400,000 businesses will start up this year. and 470,000 will die.
- According to the Small Business Administration (SBA), about 66% of small businesses will survive their first 2 years. That means about one-third of total businesses will fail during their first 2 years. If your business is part of the 34 percent, will your assets be protected? From the new car you bought for your son to the savings you've put away for you and your spouse's retirement...you could lose it all.
- Over 15 million civil lawsuits are filed each year.
- Business owners have an estimated one in four chance of being involved in a lawsuit in the next two years.
- The estimated annual cost to *every* U.S. citizen for civil lawsuits is $812.
- Awards of over $1 million are not at all uncommon in cases today.

Tax Savings

The countless tax benefits that can be achieved through a corporation far outweigh those available through any other business structure. For example, corporations are entitled (by law) to deductions not available to individuals. These tax benefits also benefit corporate owners.

Even without considering these differences, you can see that at income levels of up to $100,000 (all else being equal) corporations pay less federal income tax. This doesn't include the impact of self-employment taxes paid as a sole proprietor or of any state income taxes that may apply.

Taxable Income	Single Individual's Federal Tax (Sole Proprietorship)	Corporation's Federal Tax
$49,000	$9,060	$7,350
$74,000	$15,466	$13,500
$100,000	$22,746	$22,250
$150,000	$37,071	$41,750
$300,000*	$86,571	$100,250

***No exemption deduction accounted for individuals.**

If we add in the estimated self-employment tax (which is the Social Security payment for the self-employed) to the above scenario, the picture looks even brighter. Corporations only pay on the salary you would draw as an employee instead of on the entire taxable income of the business. Plus, corporations only pay half of the Social Security amount; the other half is taken from your paycheck.

If you take a salary that's less than the entire taxable income of the corporation, you'll pay less (between the corporation and your individual Social Security taxes) than you would as a sole proprietor paying on the entire income.

It's the responsibility of individual taxpayers to structure their business affairs in a way that minimizes their tax liability. While business owners don't want to cross the line and find themselves in legal trouble (tax evasion is a serious crime), *legal* tax reduction is the right of every business owner.

How Taxes Can Impact the Bottom Line

Which scenario delivers more dollars: increasing sales, reducing costs, or cutting taxes? It may surprise you to learn that from a pure cash-in-your-pocket point of view, a tax dollar saved is much more valuable to you than an added sales dollar or a cost-savings dollar.

A tax dollar saved is a full dollar retained in the business. The federal and state governments take a tax bite out of every other business dollar--whether it's a dollar that was retained by reducing costs or by increasing company sales. If you still aren't convinced of the critical importance of paying close attention to possible tax savings, consider the section below.

Saving on Taxes vs. Cutting Costs

Assuming an overall tax of 35 percent on your company's taxable income, if you have a 10 percent profit margin, you'd need to sell $10,000 more to generate the same benefit as saving $1,000 in costs. That's good, but when you consider the impact taxes have, you'll find that you'd need to sell $15,385 more to generate the same benefit as saving $1,000 in taxes. This is a difference of $5,385 just for spending time on tax-saving strategies rather than on cost-cutting measures.

But you might ask, what happens if tax problems *do* arise? Hundreds of thousands of Americans are audited each year and countless taxpayers are faced with tax bills they can't afford to pay. The IRS has armed enforcement officers who will raid businesses and homes to collect on past-due taxes. As a sole proprietor, the risk of an IRS audit is over seven times greater than that of a small corporation.

Beyond the IRS, there are the state tax agencies like the California Franchise Tax Board. Forbes Magazine (dated October 22, 2019), stated that "The state's Franchise Tax Board […] has a fearsome reputation. Most tax lawyers will tell you that they would much rather fight the IRS than California's FTB any day of the week."

Thanks to Nevada's three main industries - gaming, tourism, and mining - Nevada is one of only four states with no corporate income tax. Nevada has no franchise tax, no tax on corporate shares, and no succession tax. However, every corporation formed in the United States is subject to federal income taxes. But corporate federal income tax is lower than personal income taxes for taxable income up to $100,000. This is yet another reason to incorporate before you proceed in your business venture.

Insurance Protection Isn't Enough

"With setup costs and other fees, incorporating is an investment I don't really need to make. Besides, I have insurance. Isn't that enough?"

No, insurance alone isn't enough. You need small business insurance. Assuming you have purchased the right coverages, small business insurance can help protect your business in a way basic insurance can't., So many times, new business owners buy insurance policies based on an agent's recommendation. What they end up getting is a policy that protects against *some* potential pitfalls– and a whole bunch of other coverages they don't even need but end of paying for in higher premiums. Remember the chart above, and the potential savings to the bottom line for cutting costs.

Also, insurance policies have limits. What will happen to you if your business faces a lawsuit due to an accident on your property and the jury award exceeds that policy limit? Who's on the hook for every dollar above and beyond the insurance policy limit? You. Remember Rich from our cautionary tale? The lawsuit came and Rich was in danger of losing everything--including his daughter's college fund.

Be proactive. Protect yourself and your assets. Incorporate with NCH and get the peace of mind you deserve.

Now, let's talk about which entity structure is best for you.

Chapter 2: Choose the Best Entity for You

There are a myriad of options out there for the entrepreneur to choose from when it comes business structures. NCH can help with any of these structures, but we recommend and specialize in those that offer the most protection for your personal assets and provide the most peace of mind to our clients.

The chart below illustrates how the entities differ, and why a limited liability company or corporation is the best choice to protect yourself and your family. After a quick look at the chart, we'll explain each business type and then delve into getting your business set up.

Entity Comparison Chart

Type	Liability Protection	Tax Savings
Sole Proprietorship	None	None
General Partnership	None	None
Limited Partnership	For Limited Partners Only	None
Limited Liability Company	Yes	Likely
Corporation	Yes	Yes

Sole Proprietorships

Mary decides to start a graphic design business and because she's operating as a freelancer with no employees, she figures a sole proprietorship is the logical way to go. She gets a business license from the state and the appropriate local municipality, files a DBA (doing business as) certificate with the County Recorder's office and is now established as a legitimate business. While this seems like the right thing to do based on Mary's situation and the fact that sole proprietorship is the least expensive form of business to establish, other factors can make it the most expensive business structure in the long run.

The biggest issue with a sole proprietorship is the fact that there's no legal distinction between yourself and the business. That means that there's no distinction between your business and your assets.

Sole proprietors risk losing everything they have with this type of business structure. If a judgment is awarded against the business, every personal asset of the owner can be used to satisfy the judgment.

Another drawback of the sole proprietorship is that it cannot survive without you, meaning the business dies with you. There are several basic estate planning considerations particular to sole proprietorship status, but if you want to pass the business to your heirs, there are numerous estate planning and taxation issues that must be overcome.

You'll also find it difficult to raise capital as a sole proprietor. Your only option is a personal loan or investment. Limited liability entities can raise capital through third-party investment such as an issuance of stock.

What makes sole proprietorships attractive is that they're easy to operate compared to corporations. That's because there are no formalities to maintain, no meetings to hold, and no documents to draft and file. Of course, even though there are no formation hoops to jump through to set up the sole proprietorship, its business activity must still fall within federal, state and local guidelines.

It's also easier from a tax standpoint, as a sole proprietor because you do not have to file a separate business tax return. Instead, a Schedule C is attached to your 1040 and filed with the IRS. Taxes are paid based on whatever personal income tax rate applies to you. Gains and losses from the business are simply combined with other personal taxable items. Because of its simplicity, accountants and attorneys often recommend the sole proprietorship structure.

However, there are many issues to consider that these professionals often forget or ignore. Because of the lawsuit-happy world we live in, it would be foolish to assume that you're immune to losing your assets and that your privacy won't be invaded. The United States is the most litigious country in the world. You can be sued if someone trips over a rug in your house and a business can be sued for millions if someone spills hot coffee on themselves. We live in a society where if you spill a cup of coffee on yourself, you can get millions out of the company that sold you the coffee. Think about it. Do you really think you're safe?

With over one million attorneys in the U.S. today looking to make a buck (that's 1 for every 227 people), business owners must take precautions to protect their interests. Sole proprietorships are risky entities that could cost you and your family all you own, especially since there is no other entity more scrutinized by the IRS.

Just one example of this scrutiny can be found in the U.S. Government Accountability Office report based on Internal Revenue Service data. That report found that a "significant portion" of the nation's annual tax gap (money that people owe but don't pay) comes from underreporting by sole proprietors and others who own unincorporated businesses. Matter of fact it was found that at least 61 percent of sole proprietors underreported their business income. Numbers like these have led the IRS to emphasize tax enforcement on sole proprietors.

Beyond the risk of tax liability, you're also likely to miss out on some tax advantages. Sole proprietorships are limited in their ability to participate in things like federally qualified pension plans and medical reimbursement plans, both of which are available to other business entities. Sole proprietorships may also have trouble justifying full deductions for certain business expenses.

All-in-all, the sole proprietorship is certainly not a long-term business solution. If you're currently a sole proprietor, you're gambling that you'll not incur business liability, and are ignoring the many tax advantages available to you as an incorporated entity.

Advantages	Disadvantages

Ease of Formation: A sole proprietorship only requires a business license and DBA (doing business as) certificate to be filed with the state and/or local municipalities, and it's in business. **Pass-Through Tax Treatment:** The income, profits, losses, and expenses of the company flow directly through to the individual who reports the income and expenses on his/her personal tax return. This makes the sole proprietorship less complex because only one tax return is involved instead of two separate ones. However, the tax burden may be greater due to differing tax rates and treatments for individuals vs. corporations.	**Personal Liability:** The individual is responsible for all the debts and obligations of the business, as well as any judgments against it. Creditors can lien personal property even if it's not part of the business. **Lack of Continuity:** If you die or get sick, the business dies or languishes. **Lack of Investment Flexibility:** Sole proprietorships are usually financed through capital contributions of the individual or by debt as opposed to generating capital from third-party investors through the issuance of stock.

General Partnerships

Let's go back to our example of Rich for a moment…

Rich decides that he could use some help in opening his new business, Widget World. He decides to call up his college buddy, Guy, who was always good with finances. After all, he was their fraternity's treasurer and bookkeeper. So, Rich and Guy form a general partnership.

This type of entity is formed when two or more people come together for the purpose of conducting a business. As Rich and Guy form their general partnership, they must agree on which duties each will take on and what percentage of ownership each will hold. Typically, this is done with a general partnership agreement put together with the help of a business lawyer.

Like sole proprietorships, general partnerships have many of the same advantages and disadvantages. Like sole proprietorships, general partnerships are easy to form but are taxed according to the tax levels of each partner. Likewise, no liability protection is offered. Again, businesses should seriously consider the consequences of litigation without any shield to protect the owners' personal assets.

Last, but not least, a word of warning. Keep in mind that 50 percent of marriages fail even with the extensive relationship-building that occurs before the wedding. What are the odds then of having a successful and lasting business partnership given the lesser level of effort exerted in most cases? In fact, it's estimated that 90% of all business partnerships fail.

Advantages	Disadvantages
Ease of Formation: A general partnership is a voluntary association of two or more individuals or business entities who agree to work together for a common business purpose. They share their profits and losses equally or as otherwise stated in a partnership agreement. **Pass-Through Tax Treatment:** By forming a partnership, the profits and losses from the business are split and recorded on each partner's personal income tax return. Like the sole proprietorship, this may unify and simplify the process of filing taxes but offers no separation between personal and business assets. The tax burden may also be greater due to differing tax rates and treatments for individuals vs. corporations.	**Personal Liability:** Rich and Guy are each personally responsible for all the debts and obligations of, as well as, any judgments against the business. If one partner makes a mistake, it may cost both partners dearly. **Lack of Continuity:** If one of the partners ceased to be a partner, whether by retirement or by death, the partnership is usually dissolved as a matter of law. **Lack of Investment Flexibility:** General partnerships are usually financed through capital contributions of the partners or by debt.

Limited Partnerships

Limited partnerships are composed of two types of participants: general partners and limited partners. General partners accept the responsibility for and take all the risks involved in managing and conducting the business. Limited partners, on the other hand, are investors who share some risk (depending on the amount invested) but who have no participation in the actual management of the entity. Limited partners simply enjoy the profits and share in the losses based on what's stipulated in the partnership agreement. These provisions provide limited liability protection, but they don't allow for any privacy for the parties involved.

Take John and Sarah, co-workers at a government agency who decide to start their own business to consult with other firms on how to comply with the agency's requirements. Both have successful entrepreneurs as mentors who believe John and Sarah have found a unique market and have the right background to be very successful in their venture. As a result, both mentors want to invest in the company to help get it started even though they don't want to be personally liable for the business.

Beyond that, neither really has the time or the industry knowledge to participate actively in the business. For their investment, the mentors are willing to share in the operating profits and losses of the company as limited partners. John and Sarah, who each have financial and management interest in the company, will serve as the general partners. What this means is that the mentors will receive the benefit of limited liability that is afforded to all participants in an incorporated entity. However, John and Sarah are still fully personally liable and at risk as the general partners.

Other limited partnerships called family limited partnerships are often used for estate planning purposes. These vehicles allow individuals to control their assets, while still having the ability to pass ownership of those assets along to their heirs. Limited partners can substantially minimize their estate taxes. Estate planning requires careful preparation and often involves other entities as well. Be sure to consult tax-planning experts before pursuing this option.

Advantages	Disadvantages
Pass-Through Tax Treatment: The income and losses of the business flow through to the partners' individual tax returns in accordance with their partnership shares, simplifying the income reporting process. However, the tax burden may also be greater due to differing tax rates and treatments for individuals vs. corporations. **Financial Flexibility:** A limited partnership can take on more limited partners to raise additional capital. **Discounting:** Family limited partnerships take advantage of the discounting allowed by the IRS. Discounting occurs when the heirs of an estate, who have an interest as limited partners, take over the estate due to a death. The heirs can take the value of the limited partnership and discount the value by as much as one-third. This will lower any estate taxes due. **Charging Order:** If a person with an interest in a limited partnership is involved in a lawsuit for any reason and loses, the judge/jury may award damages to the other party. If this happens, the person will have to disclose their interest in the limited partnership. This can be assessed to satisfy the judgment by means of a judgment lien. However, most attorneys will not have their clients take this kind of lien because of the potential tax issues. The general partner controls the distribution of profits that comes out of the limited partnership. If the general partner(s) see that a creditor has taken ownership of the interest of the limited partner, they can decide not to distribute profits yet still report a K-1 distribution to the IRS that states the creditor is responsible for the tax obligation of the distribution, even though the profits were never distributed.	**Liability of the General Partner(s):** The general partner is fully liable for the obligations of the business. Many general partners will insulate themselves through incorporation. **Lack of Control for the Limited Partners:** The limited partners are legally precluded from participating in the management of the business. If limited partners do manage or exercise control, they can lose their limited liability protection and have personal exposure to the obligations of the business. **Lack of Investment Flexibility:** Limited partnerships are usually financed by capital contributions of the partners or by debt. Additional limited partners can also be brought in to raise money for the partnership, but this dilutes the existing partners' interest.

Corporations

We'll delve into a comparison of corporations and corporate types in-depth in Chapter 5. For now, we encourage you to go back to the top of Chapter 2 and look again at the Entity Comparison Chart. A corporation is one of two entity structures that provide entrepreneurs with the most sought-after features – limited liability and tax savings.

The other entity type is the Limited Liability Company or LLC and it's taken over in the United States as the most popular formation structure.

Limited Liability Companies (LLCs)

Let's look at another example:

Harry and Ron are two forensic experts who specialize in complementary areas. They decide to combine their expertise and write a book together. Wanting to be able to focus on their work, with minimal energy directed to the 'operations' of their partnership, they decide to form a limited liability company, or LLC, named R&H LLC. This structure will allow them to set out, in a legally binding agreement, all the arrangements (roles, responsibilities, contributions, profit distributions) at the start of the venture and will offer them both asset and liability protection superior to a partnership arrangement. Their personal assets are protected against any business claims.

Limited Liability Companies have been around for many years in such countries as South America and Germany, but they first came to America in 1977 in Wyoming.

Evidence of LLC legislation in other states around the country did not take place until the IRS made a key ruling on the taxation of this new structure. On September 19, 1998, the IRS issued Revenue Ruling 88-76, stating that LLCs would be taxed as partnerships even though none of the members (partners) or managers would be personally liable for any of the company's debt. This ruling encouraged other states beyond Wyoming to adopt this new vehicle as well. Today, all states have accepted LLCs into their domain as legitimate business structures.

The LLC structure can be used to hold property and transact any type of business. For tax purposes, LLC structures have the best attributes out of almost every other entity type – sole proprietorships, general partnerships, limited partnerships, S corporations, and trusts. An LLC is generally a pass-through entity. It passes all the company profits and losses directly to members (i.e., owners) of the LLC. Individual members are therefore taxed at their personal tax rates.

LLCs can also be handy tools when exploring joint ventures. For example, let's say you're enjoying the benefits of controlling your own corporation and now want to combine efforts with another individual by forming a joint venture. Using two corporations that you each control to form an LLC will allow the profits or losses from the joint venture to flow directly into your respective corporations. The taxable entity in this case would be the corporation. This is a simple way to bring two corporate entities together and keep the business at arm's length.

Advantages	Disadvantages
Pass-Through Tax Treatment: If the LLC is taxed as a partnership, the income and losses of the business flow through to the partners' individual tax returns in accordance with their partnership shares, simplifying the income reporting process. (You lose this benefit if your LLC is taxed as a corporation.) **Charging Order:** If a person with interest in an LLC is involved in a lawsuit for any reason and loses, the judge/jury may award damages to the other party. However, most attorneys will not have their clients accept a lien on distributions because of the potential tax issues. If a creditor takes ownership of a member's interest in the LLC, the members can decide not to distribute profits yet still report a K-1 distribution to the IRS that states the creditor is responsible for the tax obligation of the distribution, even though the profits were never distributed.	**Loss of Pass-Through Tax Treatment:** As mentioned earlier, a one-member LLC may be taxed as a corporation by the IRS or disregarded as an entity for tax purposes, you may elect to be taxed in the way that works to your advantage. In this case, you must file a separate tax return instead of reporting income on your individual return. (You still benefit from pass-through tax treatment if your LLC is taxed as a partnership.) **Federal Security Limitations:** The LLC is only available to privately owned companies. If a company were to go public, it would have to be a C corporation. With merger laws, it would be easy to convert an LLC to a C corporation. **State Tax Treatment:** Some states impose an income or franchise tax on LLCs.

Chapter 3: Reap The Nevada Edge

Now that you're familiar with all the benefits you'll gain just by incorporating, it's time to learn why Nevada is the best state to incorporate.

How Nevada Is Climbing to the Top for Incorporation

Why is Nevada considered the most business-friendly state in the U.S.? Turns out there are several reasons why.

#1: Tax-Free State

Nevada doesn't tax the income of its corporations. Unlike most states, Nevada has taken a 'pro-business' stance. Its legislature has consistently recognized that taxing the income of its businesses or its citizens would be the wrong approach for maintaining a healthy state economy. Another reason you should consider Nevada not only as your corporate home but also as your personal residence… is that it only takes six weeks to establish residency and escape the state income taxes so prevalent across the country.

Beyond paying no income tax, your Nevada corporation will have very few other taxes to contend with. You *will* be required to pay payroll tax if you have employees and may be required to pay sales tax if your Nevada corporation is selling products in Nevada. And in 2015, the Nevada legislature enacted the Nevada Revenue Plan, which includes a quarterly Commerce Tax.

But don't take our word for it – here's a list from the Nevada Secretary of State's Web site, emphasizing the key benefits of incorporating here:

- No Corporate Income Tax
- No Taxes on Corporate Shares
- No Franchise Tax
- No Personal Income Tax
- Nominal Annual Fees
- Nevada corporations may purchase, hold, sell or transfer shares of its own stock.
- Nevada corporations may issue stock for capital, services, personal property, or real estate, including leases and options. The directors may determine the value of any of these transactions, and their decision is final.
- No Franchise Tax on Income
- No Inheritance or Gift Tax
- No Unitary Tax
- No Estate Tax
- Competitive Sales and Property Tax Rates
- Minimal Employer Payroll Tax - 0.7% of gross wages with deductions for employer paid health insurance
  Nevada's Business Court
- Developed on the Delaware model, the Business Court in Nevada minimizes the time, cost and risks of commercial litigation by:
  - Early, comprehensive case management
  - Active judicial participation in settlement
  - Priority for hearing settings to avoid business disruption
  - Predictability of legal decisions in commercial matters

Additional advantages:

- Stockholders, directors, and officers don't have to live or hold meetings in Nevada, or even be U.S. citizens.
- Directors don't have to be stockholders.
- Officers and directors of a Nevada corporation can be protected from personal liability for lawful acts of the corporation.
- Nevada corporations may purchase, hold, sell, or transfer shares of its own stock.
- Nevada corporations may issue stock for capital, services, personal property, or real estate, including leases and options. The directors may determine the value of any of these transactions, and their decision is final.

#2: Asset Protection over Other States

Most states in the U.S. have adopted corporate statutes that limit the liability of corporate representatives, including the officers, directors, and stockholders. Today, however, many states are allowing lawsuits to penetrate a corporation's veil of protection. California, for example, views corporate structuring quite differently than Nevada. Whereas C corporations separate the individuals controlling the corporations from the entities themselves, California courts often make people responsible for corporate misfortunes.

Unlike Nevada's stance, more times than not, California courts will 'pierce the corporate veil,' making the individuals vulnerable and scrutinizing people for corporate matters. Outside of Nevada, more and more directors and officers of corporations are being sued for the corporation's actions. This means that an officer's personal assets could be attacked, leaving his/ her home, savings and assets completely at risk. If that's not reason enough to make Nevada your corporate base, I don't know what is.

Unlike other states, Nevada doesn't believe that the individuals controlling corporations should be in danger of losing their personal assets because of corporate matters. Nevada also doesn't believe that corporations should be responsible for the personal liabilities of its controllers. Nevada's courts have taken a firm stand to prevent lawsuits against a corporation from personally affecting the corporation's representatives.

Corporate officers and members are only in danger of personal liability if fraud has been perpetrated. Barring this, corporations can be sued, file bankruptcy or be involved in any other unfortunate activity and its owners or representatives are still protected.

The main thing to remember here is that, if your corporation does get sued, the initiator of the suit must bring the action against the corporation in its state of domicile. This is why it's important to consider where you set up your corporation *before* you set it up. . Nevada has taken a strong stand to protect the personal liability of a corporation's participants and as such, is one of the best places to incorporate.

Nevada laws provide protection for the corporate officers and directors in specific ways, as opposed to protecting at-large shareholders. For example, under NRS 78.7502, a corporation may indemnify officers and directors for any action, whether, "…civil, criminal, administrative, or investigative…" if they are a "…director, officer, employee or agent…" "…against expenses, including attorney's fees, judgments, fines and amounts paid in settlement…"

Similarly, under NRS 78.752, "A corporation may purchase and maintain insurance or make other financial arrangements on behalf of any person who is or was a director, officer, employee or agent of the corporation, or is or was serving at the request of the corporation as a director, officer, employee or agent of another corporation, partnership, joint venture, trust, or other enterprise for any liability asserted against him, and liability and expenses incurred by him, in his capacity as a director, officer, employee or agent, or arising out of his status as such, whether or not the corporation has the authority to indemnify him against such liability and expenses."

Except in the instance of fraud by a corporate principle, the decision by a Board of Directors to indemnify a principal is final and may not be set aside judicially. This kind of protection is afforded to Nevada corporate principals even if they were negligent in the performance of their duties as corporate officers and directors. It's these types of things that attest to the determination of the Nevada Legislature to continue along a course that is favorable to the tradition of protection of corporate principals in Nevada.

What Nevada Case Law Says

Since 1957, the only time Nevada courts will even consider pierce the corporate veil, is when there's been a perpetration of fraud by a corporate principal that has damaged another party.

What's significant about this rule is that, while the courts have heard cases in which corporations have been accused of many things (like responsibility for personal injuries, the failure to maintain corporate formalities, breaches of contract, non-issuance of stock, failing to select officers and directors, or even not having meetings), none of these things in and of themselves have caused a Nevada court to set aside the corporate veil.

Conversely, courts in other states consistently pierce the corporate veil for any one or more of the infractions listed above, as well as for undercapitalization, poor record-keeping, commingling of personal and business funds, signing contracts without designating corporate title, and business bankruptcy. The essential difference is that, in other states, it's been the intention of the legislatures to forcefully protect the interests of non-principal, at-large shareholders.

In contrast, it's always been the intention of the Nevada legislature, since its first session in 1864, to allow businesses to operate freely and with the assurance that, so long as they were not breaking the law to the detriment or harm of another party, they could rely on the protections afforded corporate principals by that form of business entity.

A review of Nevada case law also reveals that, while corporations have existed in Nevada since before it was even admitted as a state to the Union, it wasn't until the 1950s that Nevada's Supreme Court began to seriously consider setting aside the corporate veil as a means of compensating someone that had been damaged by the acts of a corporation's principals. (See **Nevada Tax Commission v. Hicks, 73 Nev. 115, 310 P.2d 852 (2957)**)

Even so, Nevada courts have traditionally been unwilling to pierce the corporate veil, except in those various instances in which fraud has been perpetrated to the damage of another and the circumstances are particularly deplorable. 1987 marked the first and only time a Nevada court has actually pierced the corporate veil, since 1978. (See **Polaris Industries Corp v. Kaplan, 103 Nev. 598, 747 P.2d 884 (1987)** and **Mosa v. Wilson- Bates Furniture Co., 94 Nev. 521, 583 P.2d 453 (1978)**)

To illustrate just how important it is that you incorporate in Nevada, consider the following information about piercing the corporate veil in Nevada, as opposed to other states. This court case clearly demonstrates the value inherent in Nevada statutes.

In 1983, the Supreme Court of Nevada rejected an attempt to pierce the corporate veil in **Rowland vs. Lepire (99 NV 308, 662 p. 2d 1332 (1983))**. The defendant corporation was capitalized with a mere $1,100 (but was entering into contracts worth tens of thousands of dollars), had no directors or shareholders, had held no organizational meetings of any kind, kept no formal minutes or records of corporate transactions, and drove the net worth of the corporation into negative numbers. No dividends were paid out to shareholders. No officers received salaries. No corporate record book even existed. Despite all of this, the court ruled that, "Although the evidence does show that the corporation was undercapitalized and that there was little existence separate and apart from (the two key shareholders) . . . the evidence was insufficient to support a finding that appellants were the alter ego of the corporation."

What the court basically found was that, because the corporation *did* have a contractor's license (which allowed it to legally contract to perform such services), had a checking account not commingled with those of its principals, and transacted business with the State's Employment Security Division, the corporation was not a sham or merely the alter ego of the principals. The evidence was thus considered insufficient to prove that the individuals were the 'alter ego' of the corporation or, in other words, that the officers should be considered the same as the corporation.

This is because Nevada has a stringent three-prong test to prove that one is an alter ego of the corporation. According to Nevada Revised Statute Section 78.747:

Except as otherwise provided by specific statute, no stockholder, director, or officer of a corporation is individually liable for a debt or liability of the corporation unless said person acts as the alter ego of the corporation. A stockholder, director or officer is considered the alter ego of a corporation only if all of the following are true:

1. The corporation is influenced and governed by the person asserted to be the alter ego.
2. There is such unity of interest and ownership that the corporation and the individual are inseparable from the other.
3. Adherence to the corporate fiction of a separate entity would, under the circumstances, sanction fraud or promote a manifest injustice.

Also, according to this section of the statute, the question of whether a stockholder, director, or officer acts as the alter ego of a corporation must be determined by the court as a matter of law. With this test, the burden of proof rests entirely upon the plaintiff(s). All three parts of the test must be proven to pierce the corporate veil; failure to prove any one of the three requirements will result in failure to pierce the veil. Faced with such a huge task, lawyers often abandon efforts before they even begin.

Regardless of this, it's not recommended that you ignore corporate record-keeping. The need to maintain corporate records goes beyond the possibility of having the corporate veil pierced. There are various instances in which someone will want to look at the records of the corporation, such as tax agency audits, investors looking into the viability of the corporation, or a principal needing to see history on how the company has dealt with specific situations in the past.

#3: Charging Order Protection on Corporate Ownership

As you've seen so far, Nevada is a very unique state and the laws that protect the owners of businesses in Nevada just keep getting better. In the 2007 legislature, a new statute was passed that made owning a Nevada corporation even more desirable.

Nevada included a provision that adds charging protection for the stock of closely held corporation, between two and 75 shareholders. Closely held corporations are companies that are not publicly traded on a national stock exchange but held privately, which is the most common form of ownership.

Charging order protection for stock of closely held corporation protects innocent shareholders from judgments against their fellow shareholders. Nevada is the *only* state to offer this protection!

Here's how the law works in your favor:

If one of your partners in business gets sued personally and there's a judgment against them, their creditor will not be able to take over the ownership of your partners shares of stock, thereby keeping the current ownership structure intact. Imagine if your partner had 51% ownership of your business and they lost their stock to a creditor. You may be out of business before you know it.

<u>13 Facts That Make A Nevada Corporation's Asset Protection Ultra-Strong</u>

1. There's never been a case in which a Nevada corporation's veil has been pierced when the corporation has been properly run.
2. Nevada courts have pierced a corporate veil only one time in the last 25 years, and that was because of fraud resulting in harm to another party.
3. Nevada courts have developed a strong record of case law that protects the corporate veil, making it one of the most difficult in the country to pierce.
4. Nevada is the only state that can indemnify corporate principals and protect their privacy. Officers and directors are only required to list their names in public records.
5. Nevada requires that only a corporation's president, secretary, treasurer, and one director be listed on the Initial List of Officers, as well as on the annual list to renew the corporation's filings with the state.
6. Nevada's indemnification laws vary from those of other states in that they can limit the personal liability of corporate principals by not requiring an officer or director to prevail in a lawsuit as a defendant before the corporation can indemnify him or her. Most states follow Delaware in requiring an officer or director to prevail in a lawsuit before the corporation is even allowed to indemnify that person.
7. Nevada requires only minimal disclosure of personal information at the time of start-up and at the time of annual filings. This ensures the privacy of individuals.
8. Nevada is the only state that does not share information with the Internal Revenue Service by means of a formal agreement.
9. Nevada does not require the immediate filing of an amended list of officers or directors if new officers or directors are elected or appointed after filing and during the year.
10. A Nevada corporation may be formed for the express purpose of limiting a person's liability in a lawful business venture.
11. Unlike many states, and as an added dimension to the indemnification of corporate principals, Nevada law allows for the establishment of alternate financial arrangements to protect corporate officers and directors. These include but are not limited to the creation of a trust fund for such eventuality, self-insurance, securing the obligation through the granting of a lien on corporate assets, or placing a letter of credit, surety or guarantee, to be drawn on in time of need. The value of this is in giving the corporation additional resources to draw upon to protect its officers and directors in the event of a lawsuit.
12. Nevada law requires no statutory minimum capitalization at the time of start-up, thereby removing this as a means of piercing a corporation's protective shield. Capitalization can be done with tangible or intangible property, including

services to be rendered to the corporation in the future.

13. Through broad empowerment allowances, Nevada law specifically provides for a corporation's principals to be given control over such things as the establishment of stock privileges, voting rights, the issuance of shares, etc., through provisions in the articles. These infuse the directors with tremendous flexibility and control over the affairs of the corporation since major changes in policy and procedure can be accomplished through an amendment to the articles rather than relying solely on the statutes.

#4: Financial Privacy

Another significant way in which Nevada's statutes protect corporate principals lies more in what *isn't* required, rather than in what *is* required. In many states, annual corporate filings require the inclusion of significant financial information about both the corporation and its principals. Nevada, however, takes corporate privacy very seriously. Nevada statutes outline only minimal filing requirements, so the Secretary of State's office (which is responsible for corporations) does not ask for detailed information.

The fact that the State of Nevada collects such limited information at the time of filing means there's little to share with anyone, and that includes anyone trying to make a claim against you. For example, with a subpoena from a court of proper jurisdiction, any investigative agency or attorney could access any files held by a state agency as a matter of executing the court's power. But if you incorporate in Nevada, they won't find out much.

Minimal filing requirements cannot be overlooked as contributing to a powerful corporate haven. It's a rather simple solution to one of the most potentially invasive aspects of corporate ownership.

#5: Flexibility in Controlling Corporate Operations and Functions

Another attractive aspect of Nevada corporate law is the tremendous flexibility afforded to corporate principals, especially directors, in controlling the operations and functions of the corporation. In addition to specific protection through indemnification, there is also great flexibility in determining just how much control the directors will have in directing the business of the corporation. This is accomplished through statutory allowances regarding the primary authority of what's stated in the Articles of Incorporation or the by-laws of a corporation in determining how a corporation will function.

These allowances are stated to give these primary documents more direct authority over that specific corporation than even the statutes, so long as these issues are directly addressed in the by-laws or articles and are not contrary to public policy.

This is in direct contrast to many other states whose laws set out specific guidelines and limitations for director actions in many areas of corporate activity, such as voting and the formalization of corporate decisions. The degree of autonomy with which Nevada imbues directors and shareholders makes direct control of the corporation much more subject to the desires and intentions of those principals than in many other states.

#6: No Minimum Capital Requirements

Comparison of state statutes between Nevada and other key incorporation states:

	Nevada	NY	CA	TX	DE
State laws allow for piercing the corporate veil	Yes (fraud only)	Yes	Yes	Yes	Yes
Courts regularly uphold piercing statutes	No	Yes	Yes	Yes	Yes
Statutes provide for the permissible indemnification of officers and directors	Yes	No	No	No	Yes
State laws provide for minimal capitalization of corporations	Yes	No	No	No	No
State laws provide for ease of incorporation through minimal filing requirements	Yes	No	No	No	Yes

A Nevada corporation can be organized with little capital if desired. Many states require that a corporation have at least $1,000 in capital.

#7: One-Person Requirement

One person can hold the offices of president, secretary, and treasurer, and be the sole director. Many states require at least three officers and/or directors. Thus, there is no need to bring other persons into a Nevada corporation if the owner does not desire it.

#8: Low Cost

Nevada is one of the lowest cost states in which to incorporate, charging a fee of only $150 per year to file the List of Officers with the Secretary of State as public record. This is the only document that indicates the president, secretary, treasurer and director(s) of the company and must be filed annually. Beyond that, you may need a state business license which costs $200 per year for an LLC and $500 per year for a corporation, along with any business license required by the municipality in which your business is located. (Note that these fees are subject to change.)

If you don't have a physical location in Nevada, Nevada statutes require that you use the services of a registered agent, available for an annual fee. The registered agent can file your Articles of Incorporation and List of Officers with the Secretary of State for you as well.

Once you're established, it will cost $350 a year for an LLC and $650 a year for a corporation (plus registered agent fees and/or local business licenses, if needed) in future years for the right to all the benefits of a Nevada corporation.

#9: No Need to Come to Nevada

In the U.S., you can incorporate your business in any state you choose. By doing so, if you're brought into a court of law, you'll be governed under the laws of the state of incorporation. You can use and maintain a Nevada corporation even if you're not a resident of Nevada and can establish one without ever visiting Nevada.

A corporation can be formed by mail, fax, or phone, and the person incorporating never has to visit the state, even to conduct annual meetings. Meetings can be held anywhere in the world at the option of the director(s). You will however need to set up business operations in Nevada if you attain tax benefits from using a Nevada corporation.

Working in conjunction with a competent registered agent can make this process much simpler. Your registered agent assists by providing your corporation with the services necessary to allow you to establish a base in Nevada. They'll also save you time and the expense of traveling to the state to acquire an office for your corporation. By providing you with the use of their facilities and staff, the registered agent provides your Nevada office the presence it needs, while also completing all necessary corporate paperwork for you.

One point of note – if you incorporate in Nevada and choose to do business in another state, you may need to file as a foreign corporation in the new state. Since every state has different requirements for filing, you'll need to contact the Secretary of State's office =. You'll also be held to the state tax code if you decide to do business there.

How do you know if you need to file in another state as a foreign corporation? As a rule, if you have a storefront or a license (such as a contractor) in that state, you must file in order to be authorized to do business there. Some businesses, such as Internet marketing, network marketing or a consulting business operating in several states, can set up their base of operation anywhere.

For instance, if you're sitting on a beach in Tahiti and have a network marketing business and someone calls you, can you conduct business there? Absolutely. This means no matter where you are, you can be making money, and don't need to foreign file in every state where you do business. The same is true of a web site business. This differs from a restaurant located in Seattle, Washington, for example. If the restaurant isn't open, you don't make money, no matter where you are.

#10: Beneficial Nevada Laws that Carry Across State Borders

When you're operating a business in your home state, you still have the choice of deciding in which state to incorporate. Although it would be nice to take advantage of the tax benefits of other states rather than your own, you're subject to local and state tax in the state in which you're doing business. That's, why it's best to incorporate in Nevada. You'd have the advantage of Nevada law with you wherever you go!

One of the best things about a corporation, is its durability. Not only in terms of time but, in terms of weathering the storms of litigation. What advantages does this afford the owners of a Nevada corporation who live in and do business through that corporation in another state?

First, and most importantly, if a Nevada corporation is sued in another state and is properly registered to do business in that state, that state's courts will use Nevada law to adjudicate certain issues. Second, , when you incorporate in Nevada, which has powerful laws protecting its corporations, you can take those protections with you across state lines. This dramatically enhances the protection (limitation of liability) your corporation can give you as a corporate principal.

When Nevada Law Applies Outside Its Own Borders

Remember that a Nevada corporation can conduct its internal business according to the laws of Nevada, no matter where its owners decide to live, work, or conduct the business of their corporation.

This includes matters such as:

1. When and where to have corporate meetings
2. The issuance of dividends
3. Purchase, lease, or acquisition of property by the corporation
4. Entering into contracts for and on behalf of the corporation
5. Election of officers
6. Appointment of directors

Choice-of-law doctrines are widely accepted and understood across the country. These doctrines require that if a 'foreign' corporation is registered to do business in the home state of a corporation's principals, the home state's courts use the laws of the foreign corporation's state to adjudicate various aspects of a case if that foreign corporation is sued in the home state. The choice-of-law doctrine is most often augmented through decisions made by the courts, as opposed to specific statutes. When does it apply?

The Nevada Supreme Court has said that, "… a crucial function of choice-of-law rules is that their application should further harmonious relations between states and facilitate commercial interaction between them. If we disregard this important conflict function…we would perhaps rarely find another state's laws controlling. Consequently, the clear intentions of the parties would be defeated."

Do Your Homework

With so many asset and liability protection challenges facing us today, we must remain sharp and creative. Don't take others' advice blindly. Do your homework with respect to managing the affairs of the corporation you'll control. If you're not properly informed, even your accountants or lawyers can end up giving you the wrong advice on corporations.

Nevada corporate statutes differ from most states in the country, and these professionals may be unaware of the unique advantages Nevada offers. Again, while your counsel may have the best of intentions, a lack of familiarity with the specifics can be dangerous.

Registered Agent Requirements

According to Nevada Revised Statute 78.030, corporations are required to have a registered agent at the time of formation and throughout the duration of the corporation's existence.

NRS 78.030 **Filing of Articles of Incorporation and certificate of acceptance of appointment of**

registered agent.

1. One or more persons may establish a corporation for the transaction of any lawful business, or to promote or conduct any legitimate object or purpose, pursuant and subject to the requirements of this chapter, by:
    a. Executing and filing in the office of the Secretary of State Articles of Incorporation; and
    b. Filing a certificate of acceptance of appointment, executed by the registered agent of the corporation, in the office of the Secretary of State.

The registered agent's location is where any government correspondence or legal documentation is sent. As part of their responsibilities to the state, registered agents are required to have regular business hours five days a week and to have a location accessible to the general public. Just as registered agents have responsibilities to the state, corporations are required to supply certain information to their registered agent.

The specific documentation that must remain in the corporation's file at the registered agent includes a copy of the Articles of Incorporation, the bylaws signed by an officer, and the stock ledger statement. The stock ledger statement indicates where the stock ledger (which lists the owners of the corporation) is located.

Your registered agent serves as your corporation's 'public face' by solidifying a presence at your location. They should draw attention to your corporation's 'headquarters' as much as possible. To firmly establish your registered agent as a legitimate headquarters, your corporation will need to communicate the agent's address as the corporation's physical address.

Remember, your registered agent is a buffer between the corporation and yourself. Anyone trying to locate you or the corporation must first start with your registered agent. Documents held with your registered agent can be inspected by a shareholder of the corporation with valid identification or by anyone with a court order. If a corporation neglects to use a registered agent, the state of Nevada imposes a fine of $100 to $500, according to state code NRS 78.090. Nevada Revised Statutes Sections 78.090 through 78.110 spell out the requirements and the functions of your registered agent.

Section 78.105 goes into the maintenance of records held at the registered agent's office. This section states that a corporation must maintain the required records, as discussed earlier, in written form or in another form capable of conversion into written form within a 'reasonable' time.

Although there are no penalties placed on the registered agent, corporations are subject to fines and penalties by the state if they choose to be negligent. Sub-section 5 of Sec. 78.105 states that every corporation that refuses or neglects to keep the stock ledger or duplicate copy open for inspection during business hours will have to pay the State $25 for every day of such neglect or refusal.

Corporate Advantage

Isn't it time for you to take advantage of the favorable tax laws and friendly business structures afforded to such Nevada corporations as Intuit©, Amazon.com©, Porsche©, Starbucks©, Microsoft Licensing©, Harley Davidson Finance© and Home Shopping Network©? Even major celebrities like Madonna, Elon Musk and Tony Robbins have incorporated in Nevada.

Incorporate today and put your business in the same league as the Fortune 500! Incorporating gives sole proprietors and small business owners the same benefits that major corporations enjoy. From limited liability to tax savings and asset protection, these benefits can help any entrepreneur save money and limit exposure.

Chapter 4: CREATE YOUR NEVADA LIMITED LIABILITY COMPANY

As we've already looked at in this book, LLCs are becoming increasingly popular every year. Currently, there are more LLCs being filed in Nevada than corporations. LLCs are a hybrid of a corporation and limited partnership. They protect the owners and operators from personal liability like a corporation, and they possess the "pass-through" tax benefits of a limited partnership. Additionally, LLCs do not require the typical formalities required when managing a corporation.

In Nevada, only one individual or legal entity is required as beneficial owner to form an LLC. However, the IRS can tax the single-member LLC as either a corporation or a partnership or may disregard the entity entirely. This means it would flow through your personal tax return. In most cases, the decision to structure as an LLC is driven by the desire to have profits treated as pass-through income for tax purposes, like a limited partnership.

To ensure you can do so, you need to have two persons or legal entities as beneficial owners so the IRS can't disregard the entity for tax purposes or tax the business as a corporation. While this may seem like a disadvantage because of control issues, there are alternative strategies to abate those concerns. Your 'partner' in the LLC could be a corporation you own or trust. In short, you can be your own partner.

History of the LLC

The Limited Liability Company (LLC) is a relatively new business structure, first seen in the United States when Wyoming passed a law allowing the entity in 1977. LLCs are allowed solely by state statute. An LLC is a distinct type of business that offers an alternative to limited partnerships and corporations by combining the corporate advantages of limited liability with the limited partnership advantage of pass-through taxation.

Wyoming's new law was greeted with all the fanfare of a dental patient having a root canal. In fact, the IRS ignored the entity for almost 11 years. Then, Delaware drafted and approved a new form of company legislation that combined asset protection and limitation on a member's personal liability with IRS-approved pass-through tax treatment. That legislation is now known as the modern Delaware LLC Act.

Today, all 50 states have codified LLC statutes, including Nevada.

Taking a closer look at LLCs, it's easy to see why they're so popular The LLC provides the desired limited liability while avoiding some of the drawbacks of a corporation (like double taxation and excessive paperwork). They combine the personal liability protection of a corporation with the tax benefits and simplicity of a limited partnership. In addition, they're more flexible and require less ongoing paperwork than corporations.

Owners of an LLC are called members. Since most states don't restrict ownership, members may include individuals, corporations, other LLCs, and foreign entities. There can be an unlimited number of members, or in some states – like Nevada – just one.

Member owned LLCs are analogous to partners in a partnership or shareholders in a corporation, depending on how the LLC is managed. A member's ownership of an LLC is represented by their "interest," just as partners have "interest" in a partnership and shareholders have stock in a corporation.

Personal vs. Investment Property

First, investment property differs from an individual's primary residence. A homeowner's primary residence is the place where he or she lives most of the time (legally the owner's “place of usual abode”). Investment property is usually real estate purchased to generate income, either by selling for a future profit or by creating ongoing rental income. Due to the differing purposes between a primary residence and a property purchased as an investment, several factors should be considered before deciding to purchase the latter. Understanding these factors will help you avoid headaches down the road.

Personal v. Entity-Owned Real Estate Investment Properties

Many investors own real estate investment properties personally. In other words, an investor buys the property as an individual, signing his or her own name on any purchase and/or loan documents. A more prudent way to own real estate for investment purposes is to purchase the property on behalf of a Limited Liability Company (LLC). This method not only protects the personal assets of an LLC's owner-members (cash, equity in other investment real estate, primary residence, investment accounts, retirement accounts, etc.) from litigation, but it also allows for flexible profit distribution.

> **NOTE:** Investment properties previously purchased by an individual can still be afforded the protections offered by an LLC. An investor can form a new business entity into which the existing, individually owned property is transferred.

Legal Benefits

An LLC offers many of the same legal protections that come with a corporation while still providing the flexibility that comes with limited partnerships or a sole proprietorship. Primary among those protections is the insulating of personal assets. LLC members limit their liability to the assets under the control of the entity and vice versa. Personal creditors of LLC members cannot make a claim on property owned by an LLC (or another corporate entity). On the flip side, a property owned in an investor's name, puts the investor’s personal assets at risk in the event of any injury that happens on the property.

> **Example:** An owner has rental property that’s occupied by a young couple. They have a holiday party and a guest falls down the stairs and is hospitalized. The guest sues the owner for his injuries, stating the stairs were hazardous. If the guest successfully wins the claim against the owner, any judgment more than the liability insurance, can be satisfied with the owner’s personal assets.

Tax Benefits

From a tax perspective, an LLC formed with two or more members is classified as a “pass-through” entity. As a “pass-through,” the entity's income gets passed through to its owners and claimed on those owners’ individual tax returns. Hence, it’s subject only to capital gains rates on the LLC member's ownership share, and not to corporate capital gains taxes. A corporation has its earnings taxed as a separate entity. Then, any distributions to shareholders, are taxed as capital gains. The process is known as double taxation. But with a pass-through LLC, there’s no double taxation. With just one owner-member, LLCs are taxed as a sole proprietorship and no separate tax return is required.

Estate Planning Benefits

Holding investment real estate in an LLC has estate planning advantages, as well. It makes transferring ownership in the property a more seamless process than if the property is personally owned. For instance, property owners may wish to gift certain percentages of their real estate to children or other family members. If property is personally owned, this process will require numerous trips to the county courthouse. That’s because personally held property deeds are required to be updated every time percentages of ownership change. Conversely, when real estate is owned in an LLC, the owner-members can simply issue membership certificates for the percentage gifted to the child or family member. No changes need be made to the deed with the county.

Early on, one area where LLCs were used was in replacing Sub-Chapter S Corporations where there are a large group of investors involved. Prior to the advent of the LLC, the S-Corp was the only vehicle investors had to create the limited liability they wanted and enjoy pass-through taxation. Currently, S Corporations are only allowed to have up to 100 shareholders where LLCs have no cap on the numbers of owners. One consideration here is that distributions from LLCs must pay self-employment taxes (15.3%) in addition to income taxes where S-corporations don’t pay self-employment taxes on their distributions.

So, what makes Nevada LLCs different than any other state? Well, like corporations, Nevada has developed a superior LLC that surpasses any other state with respect to its liability protection attributes.

Types of LLCs

Single member LLC

Nevada allows LLCs to be formed and operated with only one member or owner. Many states require that LLCs have at least two or more members to operate. This was more common when LLCs were first introduced in the 1980s, because LLCs were considered hybrid partnerships that had liability protection similar to corporations. More recently, many states have joined Nevada by allowing one person to own and operate an LLC. A single-member LLC is easier for tax purposes because no federal tax return is required, unless the business decides to be treated as a corporation for tax purposes. The income is reported on the member's tax return.

Multi-member LLC

First, let's dispel a misnomer. You can start a multi-member LLC even if you‘re just one person doing business. This may be advantageous for asset protection purposes as a single-member LLC runs a higher risk of being nothing more than a sole proprietorship or “alter ego” for its sole member, and thus could be pierced to get to that member's personal assets.

An individual accomplishes the multi-member status by making his spouse, a parent, a cousin or a child (who is of age) a minority member to further ensure that the company is a business and not just an extension of the majority holder. Different from the single-member entity, a multiple member LLC must file a tax return and give the members K-1 forms (showing profit or loss) to file with the members' 1040 returns.

For either a single or multiple-member LLC, you'll have an operating agreement for the company. But for a multiple-member company, you need to be more careful in spelling out each other's rights in the event of a split-up, death, or an irreconcilable disagreement.

Series LLCs

Nevada has a unique type of LLC available called the Series LLC. This type of LLC is used in large real estate owners/projects. The Series LLC allows a single LLC to set up separate holding cells for the various holdings which are all insulated from each other for liability purposes.

An example would be when a developer has 100 acres of land and is going to sell off 100 one-acre lots to individuals who will build future homes on those lots. Each one-acre lot would be held in the same LLC but held in a different series or cell of that LLC. If there‘s any litigation or creditor problem with any of those lots, the litigation would be contained to that one cell and not jeopardize the loss of the other 99 lots. Series LLCs are kept to real estate holdings.

LLC Management

Member-Managed or Manager-Managed?

The members or owners of a member-managed LLC are responsible for all operations of the business. By contrast, if members choose to have a manager-managed entity, only certain designated members (or even outside appointees) run the operations. The core difference between the two is that manager-managed LLCs can have passive investors written into the business structure. In member-managed LLCs, all owners have a voice proportional to their share.

- **Benefits of Member-Managed LLCs:**

  In most states, a member-managed LLC is the default type of LLC. This format is considered typical, particularly for small businesses with very few members. A member-managed LLC is advantageous if you want to ensure that each member has significant input regarding the operations of the business.

- **Benefits of Manager-Managed LLCs:**

  A manager-managed LLC is useful if you want your business to run more like a corporation. When an LLC is manager-managed, owners of the LLC exercise their control by voting on key company issues, rather than being actively involved in the company's day-to-day operations. This can be advantageous if the LLC has many members, if you have members who wish only to participate in a passive way and don't want to participate actively, and for those who desire anonymity. This last advantage is particularly nice in Nevada, since the state requires an LLC only list its manager(s) or managing members with the state yearly. This means all other members are virtually unknown to taxing or other government agencies.

Enhanced Indemnification for Members and Managers

Through the efforts of the Nevada Registered Agent Association and the Nevada Bar Association, Nevada has developed a set of Limited Liability Company statutes that go to the extreme to make sure that the owners (members) and operators (managers) of LLCs are completely indemnified from any personal judgment of liability. The exception here is of course in the case of criminal activity.That aside, Nevada Law does not allow business creditors or business judgments to settle on the owners or operators in any circumstance. Now that‘s real protection!

Charging Order Protection

Nevada has made charging order protection the sole remedy for any creditor that goes after the ownership interest of a member of an LLC. So, what does this actually mean? Well, let's say that an LLC has 10 owners who all own 10percent equally. One day, one of those owners' files for bankruptcy and one of his/her assets is their ownership in this LLC. The creditors can only place what is called a charging order against that ownership, but they do not get to control the ownership. This protects the other owners from having an unwanted creditor as an owner with them in their business. The creditor in this case would be able to participate in any distribution that may come from the LLC, but they have no vote over the affairs of the LLC.

Perpetual existence

Like Nevada Corporations, Nevada LLCs can have a perpetual existence. Many states cap the term of an LLC for 30 years, which means that LLCs must cease to exist at that point. This can cause serious concerns for businesses, since it requires shuffling by the owners to form a new LLC if the company is operating. Nevada did away with this limiting concept years ago and allows the LLC to extend beyond the life of its owners.

Privacy of Owners

Nevada values your personal privacy and doesn't ask for any information about the owners of their LLCs. Many states want to know who each owner of an LLC is and what percentage of ownership they have. In addition, many states want to know where the owners live and ask for their personal contact information. Much of this information is made available on the internet for all eyes to see. Nevada believes that you have a right to privacy in business and none of that information is maintained with the state. Nevada allows the LLC to simply give the name of the manager of the LLC for contact purposes, and we recommend you use your Nevada Registered Agent as the contact address.

Protection from Business Debt

Nevada LLCs protect the members and managers from the debt of the business that's operating under the LLC. There are various cases in other states where business debt can be levied against the owner of an LLC. New startup businesses have a 20 percent chance of succeeding past their first two years.

If your business fails, you don't want to be left holding the bag for your business debt. All business debt that's not personally guaranteed won't become the personal debt of the owners or operators of that business as long as that business is a Nevada LLC.

As you can see, there are many reasons why you would want to choose Nevada as the state to set up your LLC. Remember that even if you don't live in Nevada, you can own, and if necessary, register to operate a Nevada LLC in any state. Over 20,000 LLCs are formed every year by people living outside of Nevada who want to take advantage of Nevada's unique laws.

Pass-through Taxes

The U.S. Small Business Association succinctly explains this LLC advantage:

> Unlike a corporation, LLCs are not taxed as a separate business entity. Instead, all profits and losses "pass through" the business to each member of the LLC. LLC members report profits and losses on their personal federal tax returns, using a K-1 form. The business does not pay federal income taxes, although some states do apply an annual tax to LLCs.

LLC Terminology

Member Ownership: LLCs are owned by members, who are like shareholders in a corporation. Unlike S corporations, which are limited to 100 shareholders, the LLC can have an unlimited number of members. Some states even allow one member to own the LLC.

Membership Interest: A member's ownership interest in the LLC is referred to as a 'membership interest'. It's like stock in a corporation.

Articles of Organization: Articles of Organization are like a corporation's Articles of Incorporation or a partnership's Certificate of Limited Partnership; they're filed with the Secretary of State's office.

They usually include:

- The name of the LLC.
- The principal place of business of the LLC.
- The date the LLC will be dissolved, if the business is not perpetual. (NOTE: Nevada allows for perpetual LLCs; most states do not.)
- The appointment of a registered agent for service of process.

Some states also require you to list whether the LLC is managed by members (i.e., owners) or by managers. (In Nevada, you must list either the manager's name or members' names).

Generally, the members, who vote in proportion to their ownership interest, manage LLCs. If the LLC is to be managed by one or more managers, the Articles of Organization should include a provision to that effect.

Operating Agreement: The operating agreement establishes the rules for the operations of the LLC business. It's like a corporation's bylaws or a partnership agreement. The operating agreement can control things like profit distribution and how management powers are divided up amongst members or managers. An operating agreement is essential because things always go smoother when the rules for potential 'issues' (such as distribution of profits) are put in writing before the LLC gets started. Unless specifically stated in the original agreement itself, the operating agreement can only be amended with the written consent of all members.

Manager: All members of an LLC can manage the business; management can also be delegated to fewer than all members or to a single manager. A manager can be an individual, a partnership, a corporation, or in some states such as Nevada, even another LLC. Managers may appoint officers but aren't required to do this. The Articles of Organization would specify the scope of the manager's authority, if any.

Default Provision: If members don't specify their business relationship with each other in the operating agreement, the rules of the state in which the LLC was formed apply by default. Provisions imposed on the members are known as 'default provisions. In some states, the statutes include default provisions that members deem so important they don't allow them to be changed even by agreement. These are known as 'bulletproof provisions' or 'bulletproof acts.'

Chapter 5: CREATE YOUR NEVADA CORPORATION

The corporation used to be the most common business structure because offered great advantages over sole proprietorships and partnerships. But over the last 20 years or so, the LLC has usurped the corporation in popularity. This fact is due in large part to the simplicity and ease afforded by the LLC. But corporations still offer great benefits. In this chapter, we'll look at those benefits by comparing various types of corporations.

History of Nevada Corporations

Nevada adopted its Revised Statutes for corporations in 1987. Their creation was based primarily on Delaware corporate statutes, which have attracted businesses across the nation for the past century. Nevada, a long-time pro-business state, was looking for new ways to increase its revenues without having to tax the citizens or businesses in the state.

While sales, gaming, and room taxes have always been the main sources of revenue for the state, additional funds were needed to support Nevada's rapid growth. The idea of attracting revenue to the state by providing businesses with very favorable incorporating conditions proved to be a successful new source of revenue for the state and a new vehicle for the entrepreneur.

In recent years, an increasing number of business organizations have filed in Nevada. The number of new corporations filed annually rose 75 percent between 1994 and 1999. Even with Nevada's approximate population of only two million people in the entire state, over 80,000 businesses were filed in 2006. The top states for new filings are typically those with the highest population, such as California, New York, Texas and Florida.

Corporation: Defined

Black's Law Dictionary defines a corporation as:

"An artificial person or legal entity created, by or under the authority of, the laws of a state or nation, composed, in some rare instances, of a single person and his successors, being incumbents of a particular office, but ordinarily consisting of an association of numerous individuals, who subsist as a body politic under a special denomination, which is regarded in law as having a personality and existence distinct from that of its several members, and which is by the same authority, vested with the capacity of continuous succession, irrespective of changes in its membership, either in perpetuity or for limited term of years, and of acting as a unit or single individual in matters relating to the common purpose of the association, within the scope of the powers and authorities conferred upon such bodies by law. A franchise possessed by one or more individuals, who subsist as a body politic, under a special denomination, and are vested by the policy of the law with the capacity of perpetual succession, and of acting in several respects, however numerous the associations may be, as a single individual."

The common interpretation of a corporation is:

"A business that is granted a charter recognizing it as a separate legal entity having its own rights, privileges, and liabilities distinct from those of its owners."

The Corporate Business Structure

Although a corporation is separate and distinct from its stockholders, directors and officers, it's a separate entity that can only act through its members, officers, or agents. It cannot have knowledge or belief of any subject independent of the knowledge or belief of its people. A stockholder (owner or partial owner) is a holder of shares of stock in the corporation and is not in legal danger for the acts of the corporation (unless they are fraudulent and damaging or corporate formalities are not maintained). A stockholder is not the employer of those working for the corporation nor is he or she the owner of a corporate property.

This separation is an important benefit. Consider the many sizable and newsworthy lawsuits in the last few years in which negligence or other major liabilities have been charged against a corporation. From the Firestone tire failures to the breast implants and tobacco debacles, the news has been peppered with instances of high-dollar settlements to consumers affected by the products in question. In all these cases, only the corporation itself was held liable; the individual stockholders were protected as separate from the corporate entity.

A corporation is also a citizen in the state wherein it was created and does not cease to be a citizen of its state of domicile by engaging in business or acquiring property in another state. Since a corporation is solely a creature of state law, its powers are derived from the constitution and laws of the state in which it is incorporated. As an artificial person, a corporation is considered to have its domicile in the state where it's incorporated and the place where it has a statutory presence. When the corporation functions in a different state, the site of its designated resident or registered agent is sometimes called its 'statutory domicile.'

Once brought to life, this artificial entity has most of the rights and privileges that a person has. A corporation can own and operate businesses, hire employees, buy and sell goods and services, make contracts, rent office space, have checking and savings accounts, maintain retirement plans for employees, and can sue and be sued.

The death or bankruptcy of a shareholder, officer, or director doesn't affect the existence of the corporation. If it complies with the statutory requirements of the state where it's incorporated, it has a continuous existence.

A corporation may legally be a 'person' with rights of its own, but a corporation cannot walk, talk, think, or act for itself. It cannot market its products or perform any of the physical tasks required to operate a business. You and those hired to work within the structure of the corporation do all of this.

Comparison of C and S Corporations

A corporation is not just a corporation-- they vary in structure and organization. As such, you'll need to elect a tax treatment. The two typical tax treatments that most CPAs or attorneys will recommend are S and C elections. In considering the differences between S and C elections, one should keep in mind that every state has different laws for corporations. Here, we talk about the basic differences that apply no matter where in the U.S. you form the corporation.

S Election Corporation

- Allows for limited liability of the owners/officers/directors.
- Typically runs on a calendar year.
- Requires full disclosure of up to 100 corporate owners.
- Profits pass through to the individual tax return 1040. No tax brackets separate from the personal tax brackets apply.
- All profits are taxed on the owner's tax return even if not distributed.
- State taxes will apply for individuals who located in a state with an individual state income tax (NOTE: Nevada has no state income tax of any kind.)

C Election Corporation

- Allows for limited liability of the owners/officers/directors.
- Allows an unlimited number of stockholders.
- Runs on a fiscal or calendar year, which may be designated by the Board of Directors.
- Profits can be kept as retained earnings.
- Profits are taxed at corporate rates on an 1120 tax return, separate from the individual return. (NOTE: Nevada has no state corporate income tax of any kind.)
- There are several other differences between the two types of tax elections, which we will demonstrate by describing the S corporation in detail.

S Election Corporations

There are certain qualifications that the corporation must meet to elect S corporation status. To become classified as an S corporation with the IRS, you'll need to file Form 2553, and your corporation must meet all of the following requirements.

1. It must be a domestic corporation formed in the U.S.A.
2. It may have no more than 100 shareholders.
3. It may only have individuals, estates or certain trusts as shareholders.
4. It may not have non-resident alien shareholders.
5. It may only have one class of stock.
6. It must be a small business corporation (financial institutions, such as banks, insurance companies, or building and loan associations cannot take advantage of an S election.).
7. It must conform to state statutory restrictions, which limit the transfer of shares/ownership of the company.

An S election corporation operates on a December 31st calendar-year-end basis. However, as with most rules, there are exceptions. The corporation can make a Section 444 election, which allows for a tax year ending September 30, October 31, or November 30. With this election, estimated tax payments must be made that offset any advantage a shareholder might gain by having an offsetting fiscal year.

Considerations When Electing an S Corporation

- When losses flow-through the corporation, those losses can be used to offset active income from an owner. (Active income includes income derived directly from business activity.)
- If the S corporation earns active profits, the profits can be offset by losses from other businesses and/or operating expenses from a sole proprietorship.
- There is no double taxation.
- There are no penalties for excessive accumulated earnings for S corporations.
- The S corporation shareholder/employee may now deduct 100 percent of the cost of medical insurance as an adjustment to income.
- The S corporation must report premiums paid for health insurance and group term life insurance as taxable income if the shareholder owns more than two percent of the stock. However, the shareholder can still take the 100 percent deduction noted previously to help offset this.

Who Should You Use S Corporation Status

- Companies expecting start-up losses during the initial years of operation.
- Companies with no intent of going public in the future.
- Companies that do not expect to issue multiple classes of stock.
- Companies that might be subject to the Alternative Minimum Tax.

C Election Corporations

C election corporations have different tax rates than individuals. In some instances, C corporations will pay less in tax than an individual. C corporations have no limitations on shareholders. Shareholders can live anywhere in the world and can be any type of entity. C corporations give you the most flexibility but there's one major thing to consider before electing this entity: C Corporations are subject to double taxation.

S corporations allow the profits and losses of a corporation to flow directly through to the owners/ stockholders of the corporation.

All of this takes place without taxation at the corporate level, thereby eliminating the potential for double taxation. Double taxation of a C corporation occurs when the corporation has its profits taxed initially, and then the dividends paid out to shareholders are taxed again on the personal level.

Eliminating or deferring profits through proper financial management can easily deal with this problem. Double taxation typically only occurs with large corporations who have several stockholders that need the profits distributed to them at the year-end of the corporation. The owner of a corporation can decide at the end of the year what to do with the profits.

They can distribute them to the owners in the form of a dividend (not recommended), pay bonuses (wages) which are tax-deductible to the corporation, keep retained earnings (up to a maximum cap), or have a retirement plan that profits are distributed to on a tax- deferred basis. Retained earnings can be used for future growth of the company, additional investments in equipment, buying another company, advertising expenses, etc.

When the corporation has retained earnings, these profits are taxed at the corporate level, kept in the corporation, and not distributed to the owners. If the corporation's owner or officers need the money for personal expenses, they can be paid a wage in the form of a year-end bonus or set up a retirement plan to expense as much from the corporation as possible. The IRS says that it's the responsibility of taxpayers to lower their tax liability. They also say that a corporation can deduct any general related business expense. So, lower tax liability can be achieved by using good money management.

Private vs. Public Corporations

A public entity is registered with the SEC (Securities Exchange Commission) and has stock available for purchase on one of the major stock exchanges, e.g., IBM, AT&T, etc. A private corporation is one in which the ownership of the company is not available for sale on any public market.

Closely Held Corporation

A family or close group usually owns a closely held corporation, and shares are not to be sold outside the family or group. A corporation is a closely held corporation if, at any time during the last half of the tax year, more than 50 percent of the value of its outstanding stock is owned directly or indirectly by five or fewer individuals.

For the passive activity rules, a corporation is closely held if all of the following apply:

1. It is not an S corporation.
2. It is not a personal service corporation.
3. At any time during the last half of the tax year, more than 50 percent of the value of its outstanding stock is directly or indirectly owned by five or fewer individuals. "Individual" includes certain trusts and private foundations.

To figure out if more than 50 percent of the value of the stock is owned by five or fewer individuals, you'll want to consult a tax professional.

Domestic Corporation

A corporation operated in the state in which it was formed (i.e. a corporation formed in Nevada but operating in Nevada).

Foreign Corporation

A corporation that's doing business in a state other than the one in which it was formed (i.e., a corporation formed in Nevada but operating in California).

Alien Corporation
A corporation formed in a country other than where it's doing business (i.e., a corporation formed in Nevada but operating in Canada).

Professional Corporation
A professional corporation is a subcategory of the personal service corporation and is formed by one or more people to offer any type of personal service for which they must be licensed or otherwise legally authorized to render the professional services. It's generally reserved for those offering any combination of services between the fields of medicine, homeopathy, osteopathy and law.

Personal Holding Corporation
The Internal Revenue Service designates any corporation with over 60 percent passive income (for which five or less people own over 50 percent of the stock at any time during the last half of the tax year), as a 'personal holding company'. To determine whether a corporation is a personal holding company under the stock ownership principle, the rules consider stock owned by a corporation, partnership, or estate to be owned proportionately by its shareholders, partners, or beneficiaries.

Having your corporation classified as a personal holding company is not desirable because these entities are taxed the same as a regular corporation plus also charged a surtax of 15 percent on any undistributed personal holding company income. Distributions of personal holding company income to shareholders are taxed as dividends on the shareholders' personal income tax returns.

Personal holding company income includes the following:
- Taxable income from estates and trusts
- Dividends, interest, royalties, and annuities, including royalties from mineral, oil, gas, and copyrights
- Rent adjusted for the use of or the right to use corporate property, with certain exceptions

Holding Corporation
A holding corporation is different than a personal holding company. The holding corporation status is when one corporation controls other corporations, usually called subsidiaries. A corporation maintains control of a subsidiary when it owns at least 80 percent of its stock. The IRS will allow (or may request) a holding corporation to combine their income and expenses and file a consolidated tax return that includes all subsidiaries. Banks will also accept a consolidated financial statement when applying for credit lines.

Non-profit Corporation

A non-profit corporation, also referred to as a 501(c)(3) corporation, is one recognized by the IRS as tax-exempt and organized for a public or charitable purpose. A non-profit corporation must have at least one director or trustee and, upon dissolution, must either distribute its assets to the state or federal government or to another non-profit entity.

The American Cancer Society and the Muscular Dystrophy Association are two notable entities organized as non-profit corporations. Many cities in the U.S. are host to local non-profit corporations organized to meet local needs. For private purposes, however, the non-profit has severe limitations.

Most corporations that are formed 'for profit' can engage in "any lawful business activity." Non-profit corporations are required to state a specific purpose that benefits either the public at large, a segment of the community, or a membership-based group.

Contributions to 501(c)(3) corporations are exempt from federal or state taxation. Many wealthy individuals make substantial contributions in their estate plans for qualified non-profit corporations. These estate plan contributions are actively pursued by non-profits as part of their campaign for public support.

For tax purposes, the non-profit corporation must be formed for religious, charitable, scientific, educational or literary purposes in order to claim the 501(c)(3) tax-exempt status.

Advantages:

- No taxes paid on income.
- Lower postal rates on third-class bulk mailings.
- Less expensive advertising rates.
- Eligibility for many state and/or federal grants.
- Nonprofits are exclusive beneficiaries of free radio and television Public Service. Announcements (PSAs) provided by media outlets.

501(c)(3) Eligibility Rules:

- Organized and operated for charitable, educational, religious, literary or scientific purposes.
- Gains not distributed to directors, officers or members.
- Any assets remaining upon dissolution must be distributed to another qualified tax-exempt entity or group.
- No participation in political campaigns for or against candidates for public office.
- Not substantially engaged in grassroots legislative or political activities, except as permitted.

Chapter 6: Manage Your Entity

Corporate Formalities

What Are They?

Maintaining complete and accurate documentation and carrying out the business formalities without fail are imperative for protecting the corporate veil from being pierced. Formalities are procedures that use documentation to track the corporation's thought and activity process. More specifically, the formalities are handled in the form of corporate resolutions, amendments, notes, and meeting minutes of activities conducted. Assembling these forms within the corporate record book legitimizes the business conducted by validating its appropriateness, authenticity and authorization. Your corporate records can be kept simple, they just need to be done.

Why Keep Them?

Corporate formalities are necessitated by the practice called 'piercing the corporate veil,' which was discussed earlier in the book. Piercing the corporate veil refers to a procedure which occurs during litigation when lawyers attempt to make corporate representatives personally responsible for corporate matters and liabilities. Although it is virtually impossible to pierce the corporate veil in Nevada, improperly handled corporate formalities are justification enough to hold individuals accountable in many states.

Corporate Record Book

This section covers a typical Nevada corporate record book, which houses all the critical documentation for a corporation. These documents are required by Nevada statutes to get the corporation moving and place the corporation's elected officials in their respective offices.

Remember, you're not the corporation. When the corporation's elected representative makes a significant corporate decision, it should be briefly documented as a corporate resolution. All corporate documentation should be kept together. A three-ring binder works perfectly to keep all your records protected and in their proper order. (NOTE: While Nevada does not require that a corporation have a corporate seal, many out-of-state banks and title companies will want to see one; therefore, it is strongly recommended that every corporation get a corporate seal along with its record book.) Both can be ordered through your registered agent.

The primary documents to keep in your corporate record book, beyond your Articles of Incorporation, include your list of officers (required by the state), stock ledger, bylaws, minutes, and resolutions, including those addressing your annual meetings. More detail on each of these follows.

'List of Officers, Directors and Agent of:' Form

Once the Articles of Incorporation have been filed with the Secretary of State, Nevada will send you a form called the "Initial List of Officers, Directors and Registered Agent of:" that you need to fill out and mail back to them. You must file the list by the first day of the second month following incorporation. Each year, during the month of incorporation, you'll need to file a current "Annual List of Officers, Directors and Agent of:" for your corporation, which you submit along with the State's annual filing fee.

The list asks for the name of the president, secretary, treasurer, and directors of the corporation. Included with their names, you must provide an address for the current officers and directors, which is generally your registered agent's address. (NOTE: The "List of Officers, Directors and Agent Of…" form does not ask for vice president's name or address.)

This List of Officers is a matter of public record. Therefore, anyone wishing to check this information with the Secretary of State's office can do so with one simple phone call or by going online.

Stock Ledger

This document lists the outstanding shares of your corporation, along with the names of the shareholders to whom they have been issued. In short, it documents in detail the corporation's ownership. A statement as to where this ledger is kept must be filed with your registered agent.

Bylaws

Corporate bylaws set out the specific structure of a corporation. They're created and adopted by the Board of Directors of the corporation. They set forth the procedures for operations by the corporate representatives and the roles and responsibilities of each party related to the corporation.

Any specific criteria that you wish the corporation or its representatives to be bound by can be set forth in the corporate bylaws. The bylaws give the corporation an operating framework within which to work, setting the corporation's guidelines and boundaries. Any matters not specifically adopted in the bylaws of the corporation should then be set forth in corporate resolutions and approved meeting minutes.

Minutes & Resolutions

You'll find that for your own corporate protection and security, it's best to have a lot of paperwork in your corporate record book. It's a good idea to document all you wish to accomplish and have accomplished.

There are two basic ways to document the activities of a corporation. One way is through meeting minutes. The directors and stockholders provide minutes for meetings taken down by someone as the meeting progressed. This is usually the role of the secretary. The other alternative is to create a document called a corporate resolution. Corporate resolutions are the easiest way to manage and document a corporation's actions, as opposed to someone taking notes and typing out an entire meeting that has taken place.

With a corporate resolution, a physical meeting doesn't need to take place. Each director or stockholder simply signs the resolution, acknowledging that a certain proposal is approved. By signing the resolution, each stockholder or director is giving his or her approval. Both directors and stockholders can handle corporate affairs through resolutions, but it's usually the directors who hold the meetings who decide changes or address the significant business of a corporation.

There are three or more parts to every resolution. The format begins with the directors announcing the resolution. In the middle of every resolution is the 'meat' that tells what's being proposed and the decision being made. The last part includes the date of the resolution and the signatures of the directors or the stockholders. Corporate resolutions can be typed, handwritten, or kept on a computer.

Corporate resolutions or meeting minutes can be created after the fact. It is a simple practice to create corporate resolutions after something has occurred. This way you know why it was created, exactly who did it, when it happened, and what occurred. Then you can go back and create the necessary paperwork that describes your approval of the activity. Post-dating these resolutions is acceptable so long as the action takes place.

Annual Meetings

Nevada law requires that all corporations have annual stockholder and director meetings. Aside from annual fees, this is the only other requirement imposed by the state to keep the corporation in good standing.

When you plan your meetings, keep in mind that every stockholder and every director must first receive a formal notice or agree to waive their right to formal notice. This is required every year before the meeting occurs. In the Nevada Revised Statutes Section 78.370, it states that a notice must be delivered personally, electronically, or by postage-paid mail. The notice must be given no less than 10 days and no more than 60 days before the meeting. If one person controls the corporation and fills all the positions of the corporation, they can sign a simple waiver to receive notice.

The annual Board of Directors meeting involves a review of the past year, special reports by directors, nominations of next year's officers and a plan for the next year's growth.

The annual stockholder meeting usually involves a review of the past year's financial situation, a report by the Chairman of the Board about the plans for the coming year and a vote for the next year's Board of Directors.

Your corporation can have its annual meeting anywhere, as a direct expense to the corporation. Simply put together a resolution, along with minutes reflecting the appropriate location. Many corporations send their directors all over the country and around the world. They get paid to attend, they get a vacation, and they get taken care of. It's a fringe benefit for serving the corporation because they're not usually paid a lot of money to serve as directors.

Some family businesses have even made their sons and daughters directors, so the annual meeting turns into a family outing. (Don't forget to include inserts of any updates to major meeting decisions reflected in the original meeting minutes in your record book for documentation purposes.)

Registered Agent Files

Your corporation's registered agent in Nevada is required to have three forms on file for your corporation. The first is a copy of the company's Articles of Incorporation. The second is the bylaws of the corporation. The third required form is the stock ledger statement, which is the link to your corporation's stockholders. The stock ledger statement indicates exactly where your corporation's list of stockholders is located and is provided when someone presents a court order to your registered agent for viewing your corporate records.

Limited Liability Company (LLC) Formalities

Limited Liability Companies come with the unique distinction over corporations that they are not required by law to maintain unique formalities as corporation must. Corporations are required to have annual meetings for both the directors and stockholders. Corporations are expected to maintain proper minutes and resolutions in their corporate record book documenting all significant corporate affairs. LLCs are not required to maintain meetings nor minutes, making LLCs extremely popular for the entrepreneur looking to avoid the extra paperwork.

It‘s important to note, however, that while state law does not require LLCs to maintain record books, meetings and minutes, there are significant reasons why an LLC should maintain the same information t a corporation would – namely the IRS and potential lawsuits.

When the IRS audits your business (and yes it happens to all businesses at some point in time), they will ask for your corporate record book. The main thing they're looking for is whether you have acted like a bona fide business or are simply utilizing your business for personal tax reasons. If it's found out that your business has not been managed properly, you may lose some of the tax benefits afforded to your business. This would significantly increase your tax expenses.

Lawsuits are like the plague to businesses across the United States. Lawsuits can be as they're not just very expensive, but potentially lethal to a business as well. When a lawyer attacks a business, a corporation or an LLC, they'll first look to see if there are any substantial assets to go after. If not, they'll target the owners of the company.

A business entity is designed to insulate you from your business liability, but crafty attorneys are always looking for ways to go around your LLC or corporation to get to you. To make this process as difficult as possible for an attorney, we recommend that anyone who owns an LLC maintain the same level of formalities as a corporation.

LLCs haven't been around as long as corporations have which means there isn't as much case law addressing successful protection. During the discovery or fact-finding process of litigation, a thorough review of your Corporate or LLC record book is conducted. The formalities that are maintained within that book represent that actions taken on behalf of the business were done for business reasons and not personal reasons and supports the protections afforded to the business entity.

So, when it comes to maintaining your LLC, be sure to document significant transactions similar to what was previously discussed about corporations. We also recommend that you hold annual meetings for the members and managers of your LLC (refer to the previous section on: Record Book, Minutes and Resolutions, and Annual Meeting).

Corporate Hierarchy

Understanding the roles of stockholders, directors, officers and employees is crucial to the structure of any corporation. As owners, your roles can change, depending on what function and needs to be carried out. One week you're acting as the vice president, and the next you're acting as Chairman of the Board of Directors, so you have the authority to sign an important resolution. Every position in the corporate structure is different and usually corresponds with specific corporate tasks and responsibilities. We'll now look at detailed descriptions of each particular office and its duties, as well as their place in the overall corporate structure.

The corporate hierarchy starts off with a new corporate entity referred to as a 'shell.' Those with the most control and power within the corporate structure reside at the top of the hierarchy (i.e., the stockholders or owners of the corporation). The stockholders are responsible for appointing a Board of Directors to establish corporate policy and direction.

In Nevada, only one individual is required for the entire membership of the Board of Directors. More than one person may serve on the Board of Directors, if they meet the criteria, but this attribute allows one individual to maintain total control over a corporation's direction. Most corporations have anywhere from two to 100 directors serving on the board. The stockholders appoint directors based on their abilities to represent the corporation's best interests.

Directors implement the policies of the corporation's yearly and quarterly agendas. They establish financial policies according to the corporation's pre-established goals. Directors elect annual officers who will serve the roles of the president, secretary, and treasurer of the corporation, as well as any other officers or agents deemed necessary. Their decisions are made based on the experience and expertise of the potential officers.

The responsibilities of the officers include carrying out the vision of the Board of Directors. Officers plan and execute the day-to-day responsibilities of running the corporation. Immediate management issues of the corporation are determined by the officers implementing day-to-day policies. The directors are not typically involved in the day-to-day activities of the corporation, but in Nevada corporations, it's not uncommon for one person to assume a few if not all the roles in the corporation. Documentation is important to keep in mind when you wear many hats.

The following descriptions of corporate officer and director responsibilities come from the Nevada Revised Statutes, Chapter 78. These statutes establish the guidelines every corporation must follow according to Nevada law. Reviewing this information will expand your knowledge of how a corporation is regulated and legitimized by the state of Nevada.

Directors

Section 78.120 – **Board of Directors: General powers**. This section states that the Board of Directors has full control over the affairs of the corporation, subject only to the limitations provided by statute or by the corporation's Articles of Incorporation. If the stockholders adopt bylaws allowing it, the directors may make any other bylaws for the corporation. The selection of a period for the achievement of corporate goals is the responsibility of the directors.

Section 78.125 – **Committees of Board of Directors: Designation; powers; names; membership** indicates that the Board of Directors is a group that represents a corporation but has the authority to delegate to committees any and all responsibilities for carrying out the duties associated with managing the business and affairs of the corporation. Each committee must include at least one director, but, beyond that, any 'natural person' may serve on committees if appointed by the Board.

Officers

Now, let's jump over to NRS Section 78.130 – **Officers of corporation: Selection; qualifications; terms; powers and duties; filling of vacancies**. Here, we get into some of the responsibilities of the president, secretary, treasurer and any vice presidents of the corporation.

This section states that every corporation must have a president, a secretary and a treasurer. It also may have one or more vice presidents, assistant secretaries and assistant treasurers, and such other officers and agents as deemed necessary. Regardless of what offices are deemed necessary, the method for choosing the officers, the length of their terms and the extent of their powers and duties are all determined by either the bylaws or the Board of Directors.

By statute, any natural person may hold two or more offices and will hold office until either resigning, being removed or until a successor is chosen. (While the statute allows for all these things, here's a reminder. It's essential to draw up the proper paperwork for new officers or directors brought into the corporation, as well as for all other decisions and actions made on behalf of the corporation.)

Officers and Directors

Regarding the authority of both officers and directors, let's look at Section 78.135 – **Authority of directors and representatives of corporation**. This section states that the officers' and directors' authority is limited to conducting business authorized in the Articles of Incorporation by the statement of objects, purposes, powers and authorized business. Either a stockholder or the State can initiate a proceeding to stop any unauthorized activity. The stockholders may even file a representative suit against the officers or directors of the corporation for violation of their authority.

This section also states that any contract or conveyance made in the name of a corporation, and either authorized by the directors or done within the scope of the actual or apparent authority given by the directors, binds the corporation, and the corporation acquires rights thereunder. (So, remember that anything you sign is binding. The corporation is locked into any agreement you make on its behalf.)

As an officer/director, one of your responsibilities is to preserve the vitality and longevity of the corporation. The next section we will look at, Section 78.138 – **Directors and officers: Exercise of powers; performance of duties; presumptions and considerations; liability to corporation and stockholders**, speaks more to this duty.

This section states that directors and officers shall exercise their powers and act on behalf of the business in good faith, on an informed basis, and with a view to the interests of the corporation. In performing their respective duties, directors and officers are entitled to rely on information, opinions, reports, books of account or statements, including financial statements and other financial data that are prepared or presented by:

- One or more directors, officers or employees of the corporation reasonably believed to be reliable and competent in the matters prepared or presented;
- Counsel, public accountants, financial advisers, valuation advisers, investment bankers or other persons as to matters reasonably believed to be within the preparer's or presenter's professional or expert competence; or
- A properly authorized committee whose membership does not include the director or officer relying on the data as to matters within the committee's designated authority and matters on which the committee is reasonably believed to merit confidence.

However, if reliance on these sources is not warranted because the director or officer has sufficient knowledge about the matter in question, he or she is not entitled to rely on information from these sources.

Directors and officers may consider both the long-term and short-term interests of the corporation and its stockholders when exercising their respective powers with a view to the interests of the corporation.

They may also consider the interests of the corporation's employees, suppliers, creditors, customers, the community, and society-at-large, as well as the economy of the state and nation.

Lastly, this section states that, except as otherwise provided in the statutes, a director or officer is not individually liable to the corporation or its stockholders for any damages as a result of any act or failure to act in his capacity as a director or officer unless it's proven that his act or failure to act constituted a breach of his fiduciary duties as a director or officer and his breach of those duties involved intentional misconduct, fraud or a knowing violation of law.

According to Section 78.139 -- **Directors and officers: Duties, presumptions and powers when confronted with change or potential change in control of corporation**, directors may resist a change or potential change in control of the corporation if the directors, by a majority vote of a quorum, determine that the change or potential change is opposed to or not in the best interest of the corporation upon consideration of the interests of the corporation's stockholders and other relevant parties.

They may also do so if the amount or nature of the indebtedness and other obligations to which the corporation or any successor to the property of either may become subject, in connection with the change or potential change in control, provides reasonable grounds to believe that, within a reasonable time the assets of the corporation or any successor would be or become less than its liabilities, the corporation or any successor would be or become insolvent, or any voluntary or involuntary proceeding pursuant to the federal bankruptcy laws concerning the corporation or any successor would be commenced by any person.

In addition, this section states that, if directors and officers take action to resist a change or potential change in control of a corporation which impedes the exercise of the right of stockholders to vote for or remove directors, the directors must have reasonable grounds to believe that a threat to corporate policy and effectiveness exists. The action taken which impedes the exercise of the stockholders' rights must also be reasonable in relation to that threat. However, this clause does not permit directors or officers to repeal any right conferred by statute or by the Articles of Incorporation.

In short, this section addresses the responsibility of officers and directors for a corporation that is failing. It indicates that the directors and officers must act in accordance with what is best for the corporation.

To learn more about the roles within the for-profit corporate structure, visit the Nevada Secretary of State's Web site at http://nvsos.gov/sos under Business Center - Resources - Statutes and Regulations. Please note that what's not stated in the statutes may be clarified in Nevada case law. Consult a Nevada attorney for more specifics.

Your Role as 'Controller'

Now we'll discuss your relationship and responsibilities to the corporation. The best way to think about your affiliation with the corporation is that it's an entity separate and distinct from yourself. In other words, you really don't have a corporation at all. Refer to the corporation as "the entity I work for," "the entity I am contracted with" or "the entity I do business with."

On the other hand, don't refer to the entity as "my corporation;" keep this in mind at all times Don't disclose any information about your control or ownership of the corporation to individuals with whom you're affiliated. Separate yourself from the corporate identity. Always be conscious of the language you use around colleagues and business acquaintances to reflect the relationship to the corporation that you prefer.

Too often, because of ignorance or ego, people share their personal affairs with others. Exposing this information may hurt you in the future, so keep your affiliation with the corporation private.

Playing the Game

Your relationship to the corporation is essentially a role-playing game. Your role can (and likely will) change often depending on the business at hand. Think of your role as the one James Garner played in that old television show, *The Rockford Files*. In the show, the main character would have to assume professional titles to solve the case.

One day, he'd be the president of a major company, the next day a humble phone repairman. The same goes for you. One day, you'll need to be the corporation's business manager to carry out certain duties while, another day you might need to present yourself as the president of the corporation to close a big sale. Many different situations will arise that will require you to play different roles within the corporate structure.

Flexibility is key when taking on these roles and tasks. Occasionally, in order to sign a certain document, you will need to be an elected officer. It's important that you maintain accurate and sufficient documentation to support the changes in your role when required. Making contracts and getting into business dealings should be simple procedures if carried out correctly. Simply choose a title that best facilitates a task and document the change within your corporate records.

The more you practice this game in your day-to-day corporate routine, the easier it will be to verify your relationship to the corporation, should you become involved in litigation. Distancing yourself from the corporation will help prevent anyone from piercing the corporate veil. Remember, you're not the corporation. If you're ever called onto a witness stand, you need to have your relationship to the corporation very clear in your mind so that you don't hesitate to answer the questions accurately.

Remaining at Arm's Length

Part of keeping yourself at arm's length from the corporation means that you must take precautions to preserve a legitimate distance from the corporation. To validate separating yourself from the corporation, you need to make sure that you carry out business legitimately and that you never commingle funds.

Many people think it's okay to pay for small personal items or an outing here or there with corporate funds. The corporation's money is really your money, right? Wrong. Again, bad habits could have serious consequences in the future. Just as you're separate from the corporation, your money is separate from corporation money as well. Merging your money will supply compelling evidence to anyone interested in "piercing the corporate veil" by proving that the corporation is simply an alter ego of yourself.

Although it's necessary to separate yourself from the corporation, the fact is that any endeavor requires money. Unless you have a slew of investors anxious to hand over their money, chances are the start-up capital will have to come from your pocket. But remember, your generosity alone is not enough to justify giving the corporation a large sum of money to get started. Compensation is the keyword. Ask yourself, “What’s in it for me?” This should be the question on your mind because it will be the question on others’ minds should your motivation for giving the money ever be questioned.

One way to give the corporation money is through a capital contribution in exchange for stock. This is a simple and effective way to fund the corporation. The value of the stock increases with the additional capital formation. Start-up capital is non-taxable income, so invest your money wisely.

Another way to move money around is to give the corporation a loan. In exchange for the funding you give the corporation, the corporation provides you with a promissory note that contains specific payback terms, including interest acquired over time. The payback period may not be immediate; it could be given years from the time of the loan. But again, make sure that the compensation is reasonable and clearly spelled out in your corporate documents.

Regardless of how the transaction takes place, documentation of and compensation for the exchange are key. There must always be a legitimate business reason to support transactions between the corporation and yourself. You can get creative with the strategies.

For example, if your business needs to dictate purchasing a piece of property, buying a new car, or taking a trip, you can do that within the corporation. But you must be able to support it with legitimate business reasons. Keep in mind the items purchased will not be ‘yours’ per se, but rather you’re able to access these items as an employee, agent or affiliate of the corporation.

For example, let’s say the corporation purchases a corporate car and you, as the vice president, carry out important duties on behalf of the business and consequently need a car to drive. Although the car is formally registered under the corporate name and owned by that entity, you‘re allowed to drive the vehicle as a condition of your position with the business. You’ve just established a legitimate business reason for driving the corporate car.

The same basic concept can be applied to taking a vacation (by having a meeting during your trip) or buying a piece of property (for the corporation’s future investment). The more creative you are the better, but you need accurate and complete documentation to support these decisions.

Part of providing complete documentation is making sure those resolutions, checks and other important forms are accurately filled out. It’s absolutely necessary to sign the documents with the proper title when you authorize corporate decisions. Let’s say you want to buy a piece of property on the corporation’s behalf. You authorize the purchase of property, make a resolution, write a check for the given amount, and sign it with your name. Transaction complete, right? Wrong. By forgetting to sign with both your name and your title, you’ve just made a serious mistake.

Forgetting to identify your authority to sign such a form, has subjected the corporation to severe scrutiny. In fact, for such a simple and seemingly insignificant mistake, the corporate veil may very well be pierced by validating the speculation of an alter ego status.

Procedures are important. Just because you can’t buy your groceries with the corporate debit card doesn’t mean that the corporation won’t end up paying for your food – all for a legitimate business reason. Perhaps at the end of the month, the corporation will write the vice president an allowance check. This check can then be cashed, and food may be purchased at the market.

In this way, the corporation may compensate contractors, employees, and officers for all their service and hard work. Individuals that happen to live outside the state but work with or for Nevada corporations may redeem even more compensation because of the distance, additional time given, or general hassles of working for an out-of-state company.

Limited Liability Company Hierarchy

Like corporations, LLCs have specific titles/roles and expectations for these titles/roles. As we've discussed, there's less required formality-wise with running an LLC. The same goes for the organizational structure of the LLC. There are two primary titles/roles that come with LLC: Members and Managers.

Members

Ownership in an LLC is represented by membership, and an owner is titled a "Member." There can be an unlimited number of members (owners) in an LLC. Member in an LLC is synonymous to shareholders in a corporate structure. A member doesn't have any unique role or responsibilities in the operation of the business, but they do maintain the responsibility to choosing a "Manager." This manger can be the member which is called "Member-managed ". Or, as in the case of multiple members, they can choose one member to be the manager or even hire a non-member to run the LLC.

Managers

A manager in an LLC is the title given to the individual that runs the affairs of the business entity and the business itself. He or she is considered synonymous with the title of President of the corporate structure. The manager of the LLC would be the one that the public would deal with and who is a contact person for the business. The manager would act in their role at the pleasure of the members and can be replaced by a majority of the members at any time. In an LLC with multiple members, the majority member often becomes the manager of the LLC.

Funding Your Corporation

Money is put into a corporation either to fund future activities or, in the case of a small asset protection corporation, as a loan to the corporation. Loans are popular vehicles for moving money because they help individuals save money by lowering personal taxes.

There are primarily two classifications for funds that you place into your corporation's bank account: capital contributions and loans. Larger corporations will have a third class, similar to a loan, called 'corporate bonds.'

Bank Loans

Loans for corporations can be quite difficult to get unless a corporation consistently shows income sufficient to pay the loan back. New corporations are less likely to get bank loans because, like a college student just starting off, they will not have much or any kind of credit history. If you try to get a bank loan with a new corporation, chances are that you, as an individual, will have to co-sign for the corporation. This is the way many new corporations begin to build depth in their credit history.

Personal Loans

By loaning money to a corporation, you're essentially giving the corporation funds. In exchange, the corporation is going to give you a promissory note. This promissory note tells you the length of the note and the rate of return (interest) on the note. If the corporation issues a promissory note for a loan, be sure to create a corporate resolution authorizing the loan.

Capital Contributions

A capital contribution means that you're placing money into a corporation as an investor of that corporation. When you place your money into a corporation as an investment, the corporation gives you shares of stock in the corporation. The number of shares of stock that you receive is based on the value of each share. A share of stock could be valued at any price; it could be worth one dollar or one million dollars.

There are specific considerations with respect to the tax treatment of contributions from shareholders and non-shareholders, so be sure to consult with a tax professional.

Issuing Stock

A corporation is owned by its shareholders. Shareholders contribute to the corporation in the form of cash, notes, tangible or intangible property, stock or anything else of value, in a free exchange for shares of ownership (also called 'stock shares') in proportion to the accepted value of the property they contributed. Multiple owners usually agree on the value of any non-cash contributions, but single owners merely put in what they need to operate and receive 100 percent of the issued shares in return.

As the value of a corporation increases, so does the value of each share of the corporation's stock. Any additional assets placed into a corporation by its owners will increase the value of the shares in the corporation. The value of a corporation's shares is calculated by determining the difference between a corporation's assets and its liabilities, plus the value of the 'goodwill' of the corporation, divided by the number of issued shares of the corporation.

Every corporation is authorized to issue a certain number of shares of stock. This authorized number of shares is set in the Articles of Incorporation. Of those authorized shares, the corporation's directors decide how many shares they will issue. A corporation could authorize 2,500 shares and only issue one share of stock. One share of stock would then make up the entire ownership of the corporation. A corporation's ownership is only based on those shares of the corporation's stock that have been issued.

Because Nevada keeps the ownership of a corporation a private matter by not asking for any information regarding the corporation's ownership, finding out just who the owner is can become quite difficult. If the IRS or an individual who is filing suit against a corporation is trying to track down a corporation's owner, they will start with the registered agent's office. The registered agent will acknowledge that they represent that corporation. To get the documentation that the registered agent has on file (the articles, bylaws and stock ledger statement), the other party must have a court order to retrieve those documents.

This starts them on the trail to the corporate record book, because the document called the 'stock ledger statement' tells where the stock ledger (located in the record book) is kept. The stock ledger should reflect who has been issued the shares of the corporation. If your shares have never been issued, it doesn't say anything. But if they catch up with the corporate record book they've caught up with the owner of the corporation, especially if the shares have never been filled out. Even if they weren't filled out but are in your possession, a judge will say that you're the owner of the corporation. If somebody got on the trail of the corporation and went to the registered agent, the registered agent would notify you that somebody was tracing the corporation.

The corporate record book and stock could then be moved or sent somewhere else. It's then the responsibility of the owner of that corporation to provide the registered agent with the new address of where the stock ledger is kept in the form of a new stock ledger statement.

Types of Stock

Common Stock: Common stocks are stock shares that usually possess voting rights and are entitled to dividends, as declared by the Board of Directors, and to a proportionate share in the distribution of assets at the time of the corporation's liquidation. Because of these ownership characteristics, common stock appreciates or depreciates in price according to a corporation's profitability.

Voting Stock: This class of stock allows the holder of the shares a voting right for each share. Control of the corporation resides in these shares.

Non-Voting Stock: These shares are entitled to a portion of the profits, but they represent no control over operations.

Preferred Stock: Preferred stock is a class of stock with a preference over other forms of stock, normally as to dividends but sometimes as to voting or liquidation rights.

Cumulative Preferred Stock: This is a class of preferred stock that carries with it a guaranteed return. For instance, the stock may pay out a 10 percent annual dividend, but, if the company does not have a good year and there are no profits with which to pay this dividend, the 10 percent accumulates into the next year when, hopefully, there will again be profits.

Convertible Preferred Stock: These are preferred shares that allow the owners to still receive a dividend and to convert those shares into common shares and participate in the profits of the company.

Business Plans for Business Success

If you have a business, you need a business plan. As you create it, the process ensures you thoroughly think through what you plan to do and why, to give your strategies the greatest chance for success.

The business plan is what keeps you going in the right direction and gives you a yardstick by which you can measure your progress. It quantifies and helps you measure the work that will be involved and functions as the roadmap to get you where you want to go. And, if you're looking to go after any outside funding either from banks or investors, you'll need to show them a business plan to demonstrate that your plan is well-thought-out and holds considerable potential for success. A business plan goes into detail about the following areas:

- Mission, Vision and Objectives of the Venture
- The Company (its legal description, history and current situation/location)
- Products and Services (offered and planned)
- External Environment (the industry status, the economy, legal/regulatory)
- Overall Market (including analysis of the competition, size, growth, demographics, etc.)

- Target Market (the specific segment(s) your firm is or plans on pursuing)
- Analysis of Strengths, Weaknesses, Opportunities and Threats/Risks
- Sales & Marketing Strategy (including promotion, pricing, distribution, Internet, and forecasts)
- Management Team & Advisors (one of the most critical areas for influencing funding)
- Operational Plan (including equipment, labor/personnel, and production/service process)
- Implementation Plan
- Financials & Exit/Payback Strategy (to show how investors/lenders will get their return)

According to the U.S. Small Business Administration (SBA), "All capital sources will want to see your plan for the start-up and growth of your business. If you don't have a business plan, make writing one your priority." SCORE (Service Corps of Retired Executives), one of the leaders in small business assistance, advises that a thorough understanding of market and competitive factors is "essential to convince lenders that you have a valid business idea and realistic plans for business success."

Living the Corporate Lifestyle

As an officer or owner of a corporation, you should take advantage of living the corporate life. Why use after-tax dollars to pay for your automobiles, travel, computers, office equipment, certain utilities and even your kid's college education if these expenses relate to a business purpose and can be purchased with pre-tax dollars through your corporation?

A corporation can be structured so that your company can pay for any expenses that have a business purpose. Why not use this to your benefit? Sports arenas rely on corporations to pay for the VIP boxes to watch their sporting events. As the owner of a corporation, you can win big by taking your clients and employees to these events and doing it all with pre-tax dollars. Or why not join the country club with a corporate membership and golf every day with no 'out-of-pocket' expense? (Just make sure you take your favorite client along and log the date, client's or other associate's name, and the business purpose of the meeting in your business expense log so you have the documentation required if you're ever questioned.)

Many other expenses can also be paid by a corporation, including your education, legal and accounting fees, insurance, moving expenses, seminars, books, meals, entertainment, and much more. With these 'perks,' you'll find you don't need to be paid as much salary and will have a lower personal tax liability, as well. Isn't it time to start living the corporate life today?

Building Business Credit

Just as an individual can apply for credit, so can a corporation. A new corporation seeking credit is like a young adult applying for credit for the first time. It may take some persistence in obtaining the credit lines wanted, but it can be achieved.

The process of building business credit involves several factors, including:

- Establishing a D&B rating based on company financials
- Obtaining a DUNS number
- Working with existing vendors to report to D&B and Experian
- Identifying a list of companies that offer products and services on credit, who will also report

their payment experiences to D&B and Experian to help build your business credit profile
- Developing a PAYDEX of 75 or an Intelliscore of 70 or better, based on payment history with trade references
- Applying for three to five retail business credit cards

It helps to know what factors matter to those evaluating your business credit. Lenders and vendors use the following criteria to determine credit approval, limits and interest rates:

- On-time bill payment history (payment experiences)
- D&B rating
- D&B PAYDEX score
- Public records information
- Years in business
- Business tax returns
- Type of business
- Number of employees
- Location of business
- Business plan
- Trade references
- Banking references
- Accounts receivable aging reports
- Owner/officer credit scores
- Loan package - A formal presentation of everything above to present to the lender
- Credit reports - The credit reports lenders look at vary from lender to lender and vary based on the amount of funding they have available at any given time.
- Revenue
- Profits
- Business Image

Estate Planning

The most practical use of a corporation is in providing for a convenient transfer of wealth and assets to one's heirs. The corporation allows assets (that would, by their very nature, otherwise be difficult to split evenly) to be divided and controlled in precise increments.

Your corporation can be a helpful intermediary for disposing of property. Under this plan, you would transfer selected assets to your newly organized corporation in exchange for its shares of stock. You can then bequeath or transfer the desired amount of shares to your designated beneficiaries. These shares may be distributed either all at once or over a period of years, to take advantage of the annual gift tax exclusions.

The advantages are:

- Property held in the corporation may be safer from creditors than if owned by the donor or recipient of donations.
- The donor gains considerable flexibility in selecting the number of beneficiaries, as well as the division of ownership each will receive.
- The donor can immediately give beneficiaries shares of stock in the corporation that holds the assets, to avoid having to sell the assets to divide them up.

Corporate Image

Image is vital in business today. The words ‘Inc.’, ‘Incorporated’, and ‘Corporation’ command respect and promote a professional image. Individuals and businesses visualize incorporated companies on a higher level than sole proprietorships or partnerships. Major lending sources and credit card companies look more favorably upon corporations. Beyond the prestige aspect, projecting a corporate identity allows the owners and their personal assets to remain private and separate from the day-to-day operations of the business.

Other Benefits

The benefits talked about so far are the primary reasons that many individuals and businesses decide to incorporate. There are also many secondary reasons that just may make all the difference for you. Some of those reasons are:

- Control and management of a corporation is very structured and clearly understood.
- Losses by smaller corporations can be deducted personally.
- Real estate can be controlled within a corporation for the ultimate in asset protection.
- Corporations never die - they have a potentially perpetual existence.
- A corporation can provide you with free health care.
- Ownership can be easily transferred between generations.
- Corporate pension plans can allow you to put a lot of tax-deferred money away for retirement.

The list goes on and on!

Chapter 7: Build Your Business Identity

Corporate Activity Checklist

When an individual gets ready to incorporate there are many business-related matters on their mind. After incorporating, the individuals move full speed ahead into marketing and creating revenue for the new entity. Often, months roll by before they take an opportunity to make sure all the proper steps have been taken in keeping the corporation updated and bulletproof. Below is a list of questions to ask of the corporation upon incorporating, to increase your awareness of the tasks that are required now and in the future. It's recommended that you refer to this list every three months.

Start-up Tasks

1. Has an expert advisor been chosen to help guide the corporation process? Yes___ No___
2. Have you chosen a registered agent for the corporation? Yes___ No___
3. Do you fully understand the Articles of Incorporation for your corporation? Yes___ No___
4. Do you fully understand the bylaws of the corporation? Yes___ No___
5. Do you know how many shares of stock were authorized? Yes___ No___
6. Do you know what the par value of the shares was? Yes___ No___
7. Have you signed an acceptance of the appropriate officer positions in the corporate record book (including director, president, vice president, secretary and treasurer)? Yes___ No___
8. Has the secretary signed the acceptance of the bylaws? Yes___ No___
9. Have you had your first Board of Directors meeting? Yes___ No___
10. Have the appropriate directors signed the First Meeting Minutes? Yes___ No___
11. Have contracts been signed with all independent contractors? Yes___ No___
12. Has the corporation decided on the fiscal year? Yes___ No___
13. Has the corporation decided to elect S status (which you must do within 75 days from the date of incorporation) or to remain a C corporation? Yes___ No___
14. Has the corporation issued stock? Yes___ No___
15. Has the corporation recorded this in the stock register? Yes___ No___
16. Has the corporation obtained a Tax I.D. Number? Yes___ No___
17. Has the stock ledger statement been filled out by the corporation's secretary and sent to the registered agent? Yes___ No___
18. Has a copy of the bylaws and articles been sent to the registered agent? Yes___ No___
19. Was the corporate resolution filed to issue the corporate stock? Yes___ No___
20. Does the corporation have to qualify in another state? Yes___ No___
21. Has the corporation obtained a state (and local, if needed) business license? Yes___ No___
22. Has the corporation filed the Initial List of Officers? Yes___ No___
23. Has the corporate bank account been properly established? Yes___ No___
24. Have the proper promissory notes been drawn up? Yes___ No___
25. Has a DBA been filed? Yes___ No___
26. Have you attended informational workshops to increase your corporate knowledge? Yes___ No___

Ongoing Tasks

1. Have you given proper notice or used the appropriate notice for all meetings of stockholders and directors? Yes___ No___
2. Has the board of directors utilized corporate resolutions to authorize and document all major corporate acts? Yes___ No_
3. Have the corporate books been kept separate from personal transactions to avoid Yes___ No___

commingling of funds?

4. Has the corporation kept receipts for all business expenses? Yes___ No___
5. If your corporation is over a year old, have you had an annual Board of Directors meeting? Yes___ No___
6. If the corporation is over a year old, have you paid your yearly registered agent fees? Yes___ No___
7. If your corporation is over a year old, have you filed the annual List of Officers? Yes___ No___
8. Have you reviewed and updated your business plan for the current situation?

Ideally, the corporation should answer "yes" to all these questions if they are applicable. If this is not the case, set some time aside to accomplish these points. Hopefully, the corporation will never have to face a million-dollar lawsuit; if it does, these are the basic steps that need to be taken immediately to keep the corporation's veil from being pierced.

Federal Employer Identification Number (EIN)

Most official documents for taxes, reporting, corporate bank accounts, and more, require you to supply a Federal Employer Identification Number (EIN), also called a Tax Identification Number, so you will need to apply for one with the IRS early on in the process. This is your corporate Social Security number and it's the number the IRS uses to track every corporation. The IRS wants to know as much as they can about your corporation and everyone involved in it, so they ask for an individual's social security number to obtain the EIN.

The form used to apply for the EIN is called the SS-4 form. The quickest way to receive your corporate ID number is to call the IRS toll-free at 1-800-829-4933. You will just need to supply the information required on the SS-4 form over the phone to receive your number. You can also fax your completed SS-4 form to the Cincinnati, OH, IRS office at (859) 669-5760, with a cover page requesting that they fax their reply to you. (Your EIN will be faxed back within five working days.) You may also mail your form to the IRS at:

Internal Revenue Service Attn: EIN Operation Cincinnati, OH 45999

Lastly, if preferred, you can visit www.irs.gov to electronically obtain your EIN. Simply follow the instructions provided.

Nevada Business License

All Nevada corporations are required to obtain a state business license from the Secretary of State at a cost of $500 at the time of this printing, renewable annually for the same fee. Various municipalities also require a local business license to do business within their boundaries.

DBA/Fictitious Business Name Certificate

DBA simply stands for "Doing Business As…" This certificate must be filed whenever a person or a company is doing business using a different name than the actual legal name on record. The DBA, which needs to be filed with the county, will show the original legal company name, along with the name it's doing business under. A DBA is different than a business license and doesn't trademark the name, although most counties or states require you to research your proposed name to ensure it doesn't conflict with that of an existing business. One of the biggest advantages of getting the DBA handled early on is that you generally need it to open a commercial bank account in the name under which the company is doing business. In some parts of the country, you'll also need to publish your intention to use the name in a court-approved publication for a designated amount of time to inform the public of your plans.

Nevada Seller's Permit (Resale Number)

If your corporation is selling a product or any tangible item within Nevada, the State requires your corporation to obtain a State Seller's Permit. A State Seller's Permit number allows your corporation to purchase supplies to be sold by your corporation without having to pay tax on those items, as long as they are for resale. With a Resale Number, you're required to charge the appropriate sales tax on items that you sell. These taxes are collected by your corporation and paid to the State of Nevada. The State will provide the appropriate form for your corporation. Simply call the State of Nevada Department of Taxation at (775) 684-2000.

Home State Registration: Foreign Filing

Business owners who are using a Nevada Entity (corporation or LLC) but have a physical location or employees in another state will need to register their Nevada entity in that state. These business owners are utilizing Nevada for its asset protection advantages and not its tax benefits.

The terminology for filing or registering in another state is called "Foreign Filing." This means you're registering a business entity in another state that is foreign to Nevada. The process is managed by the Secretary of State's office and is unique in each state.

Most states require a document called a "Certificate of Good Standing," which is ordered through the Nevada Secretary of State. This document indicates to your new state that your Nevada entity is in good standing. The certificate of good standing is then submitted to the Secretary of State's office with that state's foreign registration forms. The fees for foreign registration also vary between states and range from $100 to $700.

Bank Accounts

Once you're ready to start using your corporation, you will want to set up a bank account. Even if you're not yet in a place to start using your corporation, it's a good idea to have a bank account set up so that everything is ready to go when your corporation is up and running.

When a corporate strategy involves using a Nevada corporation, even though the owner or representatives of the corporation don't live in Nevada, it's best to establish a Nevada bank account to further legitimize the presence of the corporation in the preferred state. If, for convenience, you want a bank account in your home state, that's not a problem.

A Nevada corporation can open a corporate bank account in any state in this country without registering to do business in that state. You may run into a few banks that will tell you that you need to

be registered in their state, but most banks are better informed. If you run into resistance or unnecessary questioning regarding your corporate matters, choose a more cooperative bank.

Establishing a Nevada bank account can be easier than setting one up in your home state. In fact, the corporate account can be set up without ever having to come to Nevada. Once your Nevada bank account is set up and you've received your bank deposit slips and checks, simply mail the bank your deposits. The bank will send you a receipt of your deposit or you can call the bank to verify that it's been posted to the account.

Brokerage Accounts

A Nevada corporation can open a brokerage account to use for investing any extra money the company may be holding. A corporation, like an individual, can invest in anything from U.S. treasury bonds to stock option contracts (a highly speculative investment).

The forms for opening an account are a bit lengthier for corporations than for individuals, but result is the same. Many brokerage firms offer special accounts to businesses to maximize the return on cash. These accounts offer checking access to funds that are earning competitive returns in national and international money fund pools. Additionally, many of these accounts come with a credit or debit card when you set up a new account.

Credit Cards

Credit cards for new corporations can be difficult to get. Corporations that don't have any credit history established are unlikely candidates for corporate credit cards. Some banks will look at the credit history of the officers of the corporation and use that as a basis for their decision. Your corporate profile increases with a credit card, but this might be what you want because it could also greatly reduce your personal profile.

Establishing a Corporate Presence in Nevada

If you utilize a Nevada corporation for tax advantages, you should visibly base your business in Nevada by having:

1. A Nevada bank account so that, wherever you're located, all corporate funds are maintained in Nevada.
2. A Nevada address for all your corporate mail.
3. A Nevada phone number, which should be listed in the local phone book and answered with your corporation name.
4. A business license in the state and county or city of your registered agent, as further proof of your Nevada base.

All these legitimizing factors help your corporation look and operates like any other Nevada-based business to prove that your corporation is based in Nevada.

Raising Capital

For the person looking to raise capital for a business or project, the corporate structure is superior to all others. Corporations allow investors to participate in the profitability and growth of a business without having to participate in its day-to-day activities. Through the sale of stock to investors, a corporation can raise capital at all phases of its life cycle. This process can be kept simple by limiting the number of investors. If a corporation is planning to raise large amounts of capital or wishes to solicit more than 25 potential investors, the rules and regulations are quite stringent. When you decide that you want to raise capital for your corporation be sure to consult with an experienced securities attorney.

Reducing Audit Risk

The minute you incorporate, your audit risk is dramatically reduced. That's because the IRS puts more emphasis on sole proprietorships than on small corporations when it comes to audits. The IRS audits 1.6 percent of all sole proprietors and only .34 percent of corporations with assets of less than $1 million.

The IRS sees an individual operating as a sole proprietor or those operating as general partners to be less sophisticated than businesses operating as corporations. The IRS also assumes that, because they're operating one of these two ways, they're more likely to make mistakes on their return. According to IRS insiders, operating your business as a corporation means you have a higher sophistication level and are less likely to misrepresent items on your taxes. In general, corporations, or at least smaller ones, are also less lucrative to audit because they're allowed more deductions and are taxed at a lower rate (in most cases) than sole proprietorships and partnerships.

This is not to say that corporations aren't targets for the IRS. But usually the corporations targeted by the IRS are those with assets over $250,000 or revenue over $3,000,000. These large corporations are a big money-making opportunity for the IRS. If a corporation with $25,000,000 in profit is off on their taxes by just a small percentage, there's a large tax collection that could be made. The IRS will spend time with those companies from which they feel they'll get the most money. Successful corporations often keep attorneys and CPAs on staff to combat the likelihood of an IRS audit.

Chapter 8: JUDGMENT-PROOF YOURSELF AND BUSINESS

Judgment-proofing your business means protecting assets within the corporate structure. Judgment-proofing protects both you and the business with strategies that involve multiple entities or just one. In today's world, lawsuits destroy businesses and lives every day. As the number of emerging lawyers exceeds demand, litigation situations will become even more intense. Limiting your exposure and protecting your assets is no longer optional – it's a necessity.

One of the main reasons business owners choose to incorporate is to avoid liability that would expose their personal assets to risk based on business activities. Within the corporate structure, personal assets are separated from the liability of the corporation. At the same time, corporate assets are protected from personal problems.

One strategy, used by companies large and small, is to separate those areas of the business that have a higher likelihood of drawing lawsuits (particularly those branches that work directly with the public) from the more valuable assets under their control. For example, construction companies may consider placing their expensive vehicles and equipment in a separate corporation altogether. In this way, if the main company is sued not all valuable assets can be attacked.

A simple way to accomplish such a goal would be to set up a second limited liability company to hold the most valuable assets, then lease the equipment back to the construction company. That way, if someone were to win a suit against the main construction company, the equipment would not be attached to the asset pool. This enables owners to simply hand over the main (vacant) corporation instead of fighting senseless litigation.

Another useful strategy for judgment-proofing your business involves encumbering your corporation with heavy debt. To initiate the strategy, the company you wish to protect borrows money from you personally or from another limited liability company or corporation. The objective is to bury the company in debt so that it's unattractive to those seeking to penetrate it. A series of loans can place the corporation at least $100,000 into debt.

To secure these debts, the loan benefactors must sign a security agreement with the borrowing entities. A security agreement is a powerful tool used to secure certain assets as collateral on a loan. Security agreements solidify the agreement between the benefactor and recipient by stating that the assets, receivables, inventory, and everything belonging to the recipient corporation is collateral for the loans. You can also add specific clauses in your security agreement that tie up the future value of the business.

Once the assets are secured, the agreement is filed for public access. The entity that has secured your property for a loan would file a UCC-1 financing statement with the Secretary of State's office in your corporation's home state and with the county recorder in the county where the assets are located. This UCC-1 states to the public that these assets are collateral for a note that is owed and that the assets are encumbered. It tells the public that they cannot touch these assets until the debt is paid. Public documentation of encumbered assets alone will sometimes discourage money-hungry lawyers during their initial asset searches.

After the UCC-1 agreements are discovered, the potential plaintiff's attorney should immediately call his client with the news that the assets of the potential defendant are completely encumbered. The attorney's second sentence will likely include something to the effect of, should the client wish to continue, the attorney will be glad to file the suite, but for a large retainer.

This strategy can be very successful when using a Nevada entity in conjunction with your home state corporation. Use a Nevada company as the lending entity to fully encumber the assets of your home state business. You as an individual remain out of the loop completely because no one has to know that you're the owner of this lending entity in Nevada.

One business can also file a UCC-1 against another for non-payment to encumber the assets of a corporation. By using this strategy against another corporation, you have a significant interest in, you could keep potential creditors away.

Even the proven effectiveness of these corporate strategies won't completely keep lawsuits away. In fact, corporations are increasingly targeted for lawsuits today. Attorneys assume that corporations have assets and therefore are worthy of pursuit. Today, 'just cause' is no longer a prerequisite to engage in litigation. Judgment-proofing your corporation is one way to prepare for the future.

Corporate Estate Planning

Moving your estate into your company is very advantageous with Nevada entities, in large part because you can pass your estate to your family without probate and attorney's costs by using a corporation. Many approaches to family estate planning are legitimate and often effective ways of preserving family estates. However, keep in mind the rapidly changing tax and legal trends when looking to preserve a lifetime of hard-earned assets. When planning your estate (especially a sizable one), you should assemble competent legal and accounting teams to coordinate proper documentation.

Planning for the next generation is important. In 2015, people could leave or give away **up to $5.43 million** without owing any estate tax. That means that under the new rules, about 99.5 percent of all estates will NOT owe any federal gift/estate tax. The exemption amount is indexed for inflation each year. We've presented incorporation as one option. Creating a trust is another way to protect your assets.

When working with an estate, start by transferring real property into your corporation or use something as simple as a living trust to protect those assets from probate. Living trusts should be set up by an attorney and range in price from $1,000 to $2,500, depending on your estate's complexity. The living trust will hold assets, such as your bank accounts, real estate, and other personal items. Keep in mind that living trusts will allow you to avoid probate, not estate taxes.

Transferring the ownership and control of a corporation to potential heirs through gifting should be started before you get into an estate tax problem. The simplest way to begin is to implement a gifting program for your potential heirs, which also will reduce your taxes. Currently, the first $11,000 gifted to any recipient is not taxed. This means you can gift corporate stock worth $11,000 to each heir tax-free. If two people own the corporation, each can give $11,000 each to every potential heir. This process can be repeated every year.

Long-term Corporate Planning

Long-term corporate planning is more than just estate planning. Estate planning normally begins when one contemplates death and has tax implications and IRS interpretations that simply don't apply here.

Long-term corporate planning is important because corporations are perpetual unless terminated by statute or by their corporate articles. They don't cease to exist because officers or stockholders die, so planning needs to be done with their future in mind. Successfully accomplishing long-term corporate planning is a dynamic feat. It leaves little for lawyers to do and so prevents legal expenses and taxes from consuming your estate. As a result, some lawyers won't want to tell you how to take advantage of long- term corporate planning because it will decrease business for them.

Below is an example of long-term corporate planning. This type of strategy is referred to as an *advanced corporate strategy*. The sequence in this long-term corporate planning strategy is important, so follow closely:

First, you establish a corporation called a shell corporation. It has no assets and no liabilities, so the stock is worthless at this point. Because it has no assets yet, stock from the corporation can be sold to your investors or heirs at one cent per share, in whatever prorated amounts you choose for how you want to have things eventually divided among them. This is not a gift because the stock has been sold to them. When someone buys stock, the objective is for it to increase in value over time. The same goes here. If the stock's value *does* increase, it doesn't mean anything illegal, unethical or strange has occurred because that was the goal all along. This can work to your corporation's and potential heirs' advantage in the long run.

Next, you take a proxy from your stockholders (or in this case your potential heirs) that allows you to hold the stock even though you don't own it. The proxy may be irrevocable so that your right to vote is guaranteed. In Nevada, a proxy must be renewed every seven years. To ensure its renewal, the shareholders should give you an option to buy the shares back at the initial price of one cent per share. The option can be worded in such a way as to expire upon your death, so it won't go through probate.

Now it's time to put your assets into the corporation, which will immediately increase the value of the stock your stockholder-heirs purchased. Remember, there are no taxes until such time as the corporation pays dividends or the stock is sold.

One way of placing assets into a corporation is to give assets to the corporation as a capital contribution on behalf of the shareholders. A gift to the shareholders is no problem if you're within the tax exclusion limits. So as discussed above, gifting must be broken down to $11,000 per individual. Another option is to put your assets into the corporation for a lifetime management contract, where you agree to provide certain services for the corporation and the corporation agrees to provide you with a house, all living expenses, and medical care. This can be an attractive option. You'll want to have a lawyer draw up this agreement in case the IRS ever decides to do an audit. They will carefully scrutinize the paperwork for this arrangement, so you'll want to be sure it's properly documented.

Yet another idea is to put assets into the corporation in exchange for a promissory note. With this arrangement, you'll make interest payments for 10 years and larger installments for principal and interest after 10 years. The note will expire upon your death. So put your assets in, get some return on them, and when you die the note expires and the assets end up with your heirs.

No matter how you put your assets into the corporation, you can still control all of them because of the proxy while your heirs own the assets before your demise. This means no probate, no estate taxes, and no hassles. In both cases, you retain complete control of the assets and legally reduce or eliminate inheritance taxes.

Voting vs. Non-Voting Stock

One way to sell your heirs regular shares of stock and take a proxy is to sell them non-voting common stock of the corporation so you control all the voting shares. Their stock is in non-voting shares until your death, at which time whatever percentage you have left would then be passed to them. The voting shares would then be broken down among them.

Plan for Tomorrow Today!

Most people hesitate to transfer assets to their children because they don't want to lose control of those assets. There's also concern as to how their children will manage the assets. By being creative, you can give assets to your children (for future benefits) without their interference until your percentage of the assets are released upon your death. You can secure your assets for the future with proper planning, so start today.

Your Paper Trail

When you begin using these corporate strategies, you must stay on top of your record-keeping. Be sure to plan out your corporate objectives and create the proper documentation. Resolutions, promissory notes, and/or contracts must be drawn up. Don't risk all that you've developed by opening your corporation up to corporate veil piercing. Keep proper documentation.

Tax and Asset Protection Strategy

There are numerous ways to use a Nevada entity to your benefit--even if you live in another state. The strategies below will show you how a Nevada corporation or limited liability company can help you save on taxes, protect your assets, and more.

Tax-Saving Strategies

Let's look at creative ways of reducing taxes. Remember, all these strategies must be properly handled and documented. Every piece of paperwork must be in place to ensure that these plans are within the law. Creatively reducing taxes is perfectly legal.

1. Home State Corporation Strategies

Nevada is a tax-free state; there are no corporate or personal income taxes. This is significant when you compare it to states like California, where you will pay 9.3 percent on anything over $47,055 of personal income. With a just a few simple strategies, that amount (over $7,000 on $100,000 of income) can remain in your business.

So how does it work? For starters, not everyone will be able to use these strategies. These strategies are for the self-employed and those who manage their own businesses - small or large. The first step is to establish a Nevada corporation to work with your current non-Nevada corporation. Then, you'll want to place a Nevada corporation in a position where it will be providing a service or leasing equipment or property to your non-Nevada corporation. Your Nevada corporation can act as a supplier, consultant, marketing service, advertising service, management company, or financier. All these businesses could provide a service to your current home state corporation.

Your current home state business can then divert profits that are being taxed and direct those profits into Nevada where there will be no state taxes. For instance, if your home state business sells computers, why not have your Nevada corporation purchase the computer from your present supplier, mark it up to near retail, and sell it to your home state business to be resold. You have just left all the profit from the sale of the computer in tax-free Nevada and reduced or eliminated any home state tax that you'll have to pay. Now, if this strategy is implemented in a high tax state like California, your overall tax savings can be substantial.

Here's an example. Let's say that your California business is doing quite well and that you end up with $100,000 in net profits per year, $7,384 of which is being paid to the state for taxes. You then create a Nevada corporation that's going to provide marketing services to your California business. This new business could charge about $100,000 for the marketing expertise they're providing your California business. You've now successfully taken all of your profit that would have been left in your California business and taxed for $7,384 and moved it into Nevada where it's not taxed at all. In short—you've just legally saved yourself a bundle.

This same strategy can be modified to fit about any type of business situation in any state. With businesses going into bankruptcy every day, you need to take aggressive measures for the survival of your business.

Financing. When using a Nevada corporation in conjunction with a home state corporation, one of the best strategies is to make your Nevada corporation into a financing corporation. In Nevada, there's no such thing as a usury law; therefore, you can literally charge an interest rate of 25 percent. If you can lend $100,000 from a Nevada corporation to your home state corporation, you can easily draw out $25,000 a year in interest from a state that taxes businesses and put it into Nevada, which doesn't. You would still pay your federal tax, but you would eliminate all or a substantial portion of your state taxes.

Be sure when you utilize any of these strategies that all of your documentation is in place to show that there was a resolution to authorize the loan and that a promissory note was signed. You may also want to pledge the assets of your home state business against the note to encumber them.

2. The $50,000 Savings Plan

Corporations can be fantastic tax saving devices for individuals who want to start saving of their hard-earned money. If you're a person with flexibility over how you're paid, you may find this strategy useful.

Let's say, for example, that Mary makes $100,000 a year as a self-employed individual doing computer

maintenance. She decides to set up a Nevada corporation and earn her income corporately. Instead of taking the entire $100,000 as income, she decides to take a $50,000 salary and leave $50,000 in her Nevada corporation, which only has a federal tax liability of 15 percent. If she had earned her $100,000 personally, she would have paid the IRS up to 28 percent, plus 15.3 percent self-employment tax and her state taxes, for a total of over $38,000 in income-related taxes. Now that she can leave $50,000 in the corporation for future business growth, she and the corporation combined only have to pay $24,360 for federal income tax and Social Security, a savings of over $13,500 on just $100,000 of income. Better yet, let's say Mary placed the $50,000 left in her corporation into an aggressive retirement plan. This would allow her to eliminate 100 percent of the
Federal tax on that $50,000.

Sometimes it's considered best to expense as much of a corporation's income as possible to reduce corporate taxes. Reduction of corporate income is handled through legitimate business expenses that can eliminate any corporate income tax. If, however, one of the only ways that you have of eliminating your corporate profits is to draw out those profits as income to yourself, then you may want to consider leaving the profits in the corporation.

In working out corporate strategies, one needs to look at corporate and individual tax rates. On corporate profits of up to $50,000, a corporation pays only 15 percent tax. This differs from personal income tax rates where, on that same $50,000, you would be paying up to 25 percent just in federal tax. Comparing these rates, it should become clear that if an individual could operate under a corporate shelter and only draw out of that corporation enough income to get by, he or she would see a 35 percent savings in tax dollars by leaving the money in the corporation.

How can you receive the benefits of those funds now held by your corporation? Well, these unused profits can go towards investments, future business opportunities, life insurance, and many other alternatives that would directly and indirectly benefit the corporation's owners. Always remember, that once these retained earnings (profits) are removed from the corporation as personal income, they will be taxed at your current personal tax rates. However, if you control the corporation, there are many alternatives to taking funds out as a salary or bonus to yourself.

One option, with the low-taxed retained earnings in the corporation, would be to give yourself a loan. A Nevada corporation can make a loan to one of its corporate officers, and the officer doesn't need to consider these funds as income. This strategy is a clever way for you to personally use corporate funds without paying any personal income tax on funds.

Let's consider another alternative for using these low-taxed retained earnings or corporate profits for your personal gain without personal tax. In this example, corporate profits (of which up to $50,000 are only taxed at 15 percent) have built up and now amount to a cash accumulation of $150,000. You live in a house worth approximately $150,000. As a corporate officer, you decide to purchase the house as an investment for the business. As the owner of the property, the corporation would pay you $150,000. You still control your property, but you have successfully moved $150,000 into your pocket – tax-free! This example does have other implications, (for example, you must pay rent to the corporation if you still live there) but, for purposes of this section, we'll keep things as simple as possible.

3. *Retirement Plans to Maximize Tax Savings*

Putting corporate income into a retirement plan can offer you immediate tax savings, as well as long-term benefits. One of the most advantageous retirement plans is a defined benefit plan, especially for individuals who want to retire within seven to 15 years and have significant dollars to contribute.

Compared to other plans established at the age of 40 or older, the payouts of defined benefit plans can be much larger because the limits on contributions are much higher as your age increases; the limits do, however, depend on your level of compensation. So, for example, if your salary is $62,500, the maximum contribution at age 40 is $125,500, but, at 50, the maximum is $214,500. The closer you are to retirement, the more you can contribute on a tax-advantaged basis. All contributions are tax-deferred and are considered a corporate expense. Beyond these tax-deferral and payout benefits, you can also contribute up to $10,000 on behalf of non-compensated family members and take loans of up to $50,000 against the plan.

So, let's say Robert is in his early forties and realizes he'll need more for his retirement than he had previously planned. On top of that, even though the corporation could easily pay him $162,500 a year, he really doesn't need much take-home income because the corporation owns most of the assets he uses. Instead of taking the entire $162,500 a year in salary and paying taxes on it, he sets up a defined benefit plan, puts $100,000 into it on a tax-deferred basis and takes a taxable salary of only $62,500, saving himself over $28,000 in taxes this year.

4. *Non-taxable Exchange of Property for Stock*

In many cases, you can transfer property (or money and property) to a corporation in exchange for stock in that corporation without the exchange being taxable if you're in control of the corporation immediately afterwards. This rule applies both to individuals and to groups who transfer property to a corporation, whether the corporation is just being formed or is already operating. If a group of transferors exchange property for corporate stock, they don't each have to receive stock in proportion to his or her interest in the property transferred. For tax purposes, if a disproportionate transfer takes place, it may be treated as if the stock were first received in proportion and then some of it used to make gifts, pay compensation for services, or satisfy the transferor's obligations. These considerations may offer significant tax savings while also allowing you to build the value of your corporation.

To be considered 'in control' of a corporation, you or your group of transferors must own, immediately after the exchange, at least 80 percent of the total combined voting power of all classes of stock entitled to vote and at least 80 percent of the outstanding shares of each class of non-voting stock of the corporation. A corporation that receives property from you in exchange for its stock generally has the same basis you had in the property, increased by any gain you recognized on the exchange. However, the increase for the gain recognized may be limited. Both the corporation and any person involved in a non-taxable exchange of property for stock must attach a complete statement of all facts pertinent to the exchange to their income tax returns.

So how does this work? Let's say you and Bill Jones buy property for $100,000. You both organize a corporation when the property has a fair market value of $300,000. You transfer the property to the corporation for all its authorized capital stock, which has a par value of $300,000. No gain in income is incurred by you, Bill, or the corporation since the values of the stock and the property are equal.

Now let's say instead that you and Bill transfer the property with a basis of $100,000 to a corporation in exchange for stock with a fair market value of $300,000. This represents only 75 percent of each class of stock of the corporation. The other 25 percent was already issued to someone else. You and Bill recognize a taxable gain of $200,000 (the difference in value of the stock compared to what you contributed) on the transaction. The corporation pays no tax because it had no gain.

There are several situations, however, in which an exchange may (or will) be taxable, including when:

- The corporation is an investment company.
- You transfer the property in a bankruptcy or similar proceeding in exchange for stock used to pay creditors.
- The stock is received in exchange for the corporation's debt (other than a security) or for interest on the corporation's debt (including a security) that accrued while you held the debt.
- The stock is non-qualified preferred stock, which is treated as property other than stock.
- For a detailed definition of non-qualified preferred stock, see section 351(g)(2) of the Internal Revenue Code.
- Property of relatively small value (less than 10 percent of the fair market value of the stock and securities already owned or to be received for services by the transferor) is involved, if the main purpose of the transfer is to simply help make the value of property equal to the value of stock so other transferors don't recognize a gain or loss.
- You are providing services to the corporation in exchange for stock. If you, for example, transfer property worth $35,000 and render services valued at $3,000 to a corporation in exchange for stock valued at $38,000 and own 85 percent of the outstanding stock right after the exchange, you will not owe taxes on the exchange of property because the value of the property is equal to the value of the stock ($35,000). However, you will owe tax on the $3,000 of stock received as payment for services rendered to the corporation because the term 'property' does not include services rendered or to be rendered to the issuing corporation. The value of stock received for services rendered qualifies as ordinary income.
- You also receive money or property other than stock in the exchange. You are taxed only up to the amount of money plus the fair market value of the other property you receive. The rules for figuring the taxable gain in this situation generally follow those for a partially non-taxable exchange, like the previous example. If the property you give up includes depreciable property, the taxable gain may have to be reported as ordinary income because of depreciation. No losses are recognized if you own, directly or indirectly, more than 50 percent of the corporation's stock, even if you do not control the corporation.
- The corporation assumes your liabilities in an exchange. This exchange is only treated as if you received money or other property if there's not a good business reason for the corporation assuming your liabilities. Your main purpose in the exchange is to reduce federal income tax, or the liabilities are more than your adjusted basis in the property you transfer. In the last case, gain is recognized up to the amount of the difference unless the assumed liabilities give rise to a deduction when paid, in which case no gain is recognized.

For example, let's say you transfer property to a corporation for stock and are in control of the corporation immediately after the transfer. You also receive $10,000 in the exchange. Your adjusted basis in the transferred property is $20,000. The stock you receive has a fair market value of $16,000. The corporation also assumes a $5,000 mortgage on the property for which you are personally liable. Gain is realized as follows:

Fair market value of stock received	$16,000
Cash received	$10,000
Liability assumed by corporation	$ 5,000
Total received	$31,000
Minus: Adjusted basis of property transferred	$20,000
Realized gain	$11,000
Recognized gain	$10,000

The liability assumed isn't treated as money or other property. The recognized gain is limited to $10,000, the amount of cash received. For more information on the assumption of liabilities, see section 357(d) of the Internal Revenue Code.

Because of the many exceptions and the complexities of the rules related to non-taxable property exchange, you'll want to consult a professional tax advisor to ensure you make the most of this strategy.

5. Real Estate Strategies

If you're reading this manual, then you're likely in the business of buying property and using it to create income in one of two ways. You may be "flipping" or rehabbing properties to turn over quickly for a profit. It used to be that the most effective means to accomplish these goals, while keeping your business assets separate from your personal belongings, was to buy and sell the real estate using a Nevada S corporation that's foreign-filed in the state(s) where you buy and turn over property. At the same time, you would establish a C corporation in Nevada to provide transactional and management services to the S corporation, and the income would flow to the C corporation for services rendered instead of being taxed as profit for the S corporation in the state where the buying and selling occurs.

Nevada corporations can own real estate in any state in the country without having to register with that particular state, as long as the corporation is not buying and selling properties frequently in a particular state or region. In this scenario, real estate may be bought and sold without many restrictions.

Corporations can save lots of money this way, considering that some states can charge very high registration fees.

Still, there's a simpler and easier strategy now. The corporation strategy above still works, yes--but the rise of the Limited Liability Company has made things so much cleaner. For those of you flipping or rehabbing houses to sell quickly, purchasing and selling those properties through the Nevada LLC (remember above, that Nevada corporate entities can own property in any state, potentially, without registering) accomplishes in one step what the corporations do in two.

The purchase and sale, as well as expenses for the rehab all run through the LLC bank account, then any profit after sale is distributed to the members as income. Because the proceeds start with and flow through the LLC account as business monies, members of the LLC avoid co-mingling of business and personal funds, and take a large step to avoid a potential plaintiff's lawyer in a lawsuit from claiming the LLC is nothing more than an "alter ego" for those members.

For those of you purchasing properties to hold, rent out, and reap the passive income from those rents long-term, a disregarded pass-through LLC becomes an easy answer. The one difference between an active LLC thru which you may do your rehabbing business, and the disregarded LLC, is that we really may not want the LLC to hold or own the properties itself. Instead, at NCH we highly recommend the use of real estate privacy trusts (REPTs) to individually hold your rental properties, and use your disregarded LLC as the trust's lifetime beneficiary to collect the rents, pay expenses and distribute profits back to the members through that LLC's bank account.

Why don't you want to hold all the properties in the LLC in this case? Potential liability.

Should a lawsuit happen, and more than a single property is owned by the entity that owns the property on which the plaintiff has suffered the injury, a judgment in court can put a lien against any assets owned by the entity that has been sued in order to satisfy the judgment. So, instead, put each property into its own REPT. The trust is what must be sued as the owner of the property, effectively separating the rest of your business holdings from the one being sued (and not putting those other properties at risk).

6. 'Working' the Stock Market

A Nevada corporation strategy can be very advantageous for someone who practices day-trading in the stock market. Basically, no matter where you're located, you establish a limited partnership in Nevada for which you're the limited partner. You then establish a Nevada corporation (that you control) and make it the general partner that manages the portfolio. The limited partnership pays the Nevada corporation for management services, thereby legally reducing the income tax on any profit you make.

Paying and Filing Income Taxes

The federal income tax is a pay-as-you-go tax. A corporation generally must make four equal installments of estimated tax payments throughout its tax year. After the end of the year, the corporation must file an income tax return. This section will help you determine when and how to pay and file corporate income taxes.

Estimated Tax

Generally, a corporation must make installment payments of estimated tax if it expects its annual tax (income tax minus credits) to be $500 or more. If the corporation doesn't pay the installments when they're due, it may be subject to an underpayment penalty. This section will explain how to steer clear of this penalty.

When to pay estimated tax. Installment payments of estimated tax are due by the 15th day of the 4th, 6th, 9th, and 12th months of the corporation's tax year.

Example 1. Your corporation's tax year ends December 31. Installment payments of estimated tax are due on April 15, June 15, September 15, and December 15.

Example 2. Your corporation's tax year ends June 30. Installment payments of estimated tax are due on October 15, December 15, March 15, and June 15.

If any due date falls on a Saturday, Sunday or legal holiday, the installment is due on the next regular business day.

How to figure each required installment. Use **Form 1120-W** as a worksheet to figure each required installment of estimated tax. You'll generally use one of the following two methods to figure each required installment. Word to the wise—use the method that requires the smallest installment payments.

*NOTE: In these discussions, 'return' refers to the corporation's original return. However, an amended return is considered the original return if the amended return is filed by the due date (including extensions) of the original return.

Method 1. Each required installment is 25 percent of the income tax the corporation expects to show on its return for the current year.

Method 2. Each required installment is 25 percent of the income tax shown on the corporation's return for the previous year.

To use Method 2:

1. The corporation must have filed a return for the previous year.
2. The return must have been for a full 12 months.
3. The return must have shown a positive tax liability (not zero).

Also, if the corporation is a large corporation, it can use Method 2 to figure only the first installment.

A large corporation is one with at least $1 million of modified taxable income in any of the last three years. Modified taxable income is taxable income figured without net operating loss or capital loss carry-backs or carryovers.

Other methods. If a corporation's income is expected to vary during the year because, for example, its business is seasonal, it may be able to lower the amount of one or more required installments by using one or both of the following methods:

1. The annualized income installment method
2. The adjusted seasonal installment method

Use Schedule A of Form 1120-W to see if using one or both methods will lower the amount of one or more required installments.

Refiguring required installments. If, after it figures out and deposits estimated tax, the corporation finds that its tax liability for the year will be much more or less than originally estimated, it may have to refigure its required installments. If earlier installments were underpaid, the corporation may owe an underpayment penalty.

An immediate catch-up payment should be made to reduce the amount of any penalty resulting from the underpayment of any earlier installments, whether caused by a change in the estimate, by not making a deposit, or by mistake.

Underpayment penalty. If the corporation doesn't pay a required installment of estimated tax by its due date, it may be subject to a penalty. The penalty is figured separately for each installment due date. The corporation may owe a penalty for an earlier due date, even if it paid enough tax later to make up for the underpayment. This is true even if the corporation is due a refund when its return is filed.

Form 2220. Use Form 2220 to determine if a corporation is subject to the penalty for underpayment of estimated tax and, if so, the amount of the penalty. If the corporation is charged a penalty, the amount of the penalty depends on the following three factors:

1. The amount of the underpayment.
2. The period during which the underpayment was due and unpaid.
3. The interest rate for underpayments that's published quarterly by the IRS in the Internal Revenue Bulletin.

A corporation doesn't generally have to file Form 2220 with its income tax return because the IRS will figure any penalty and bill the corporation. However, even if the corporation doesn't owe a penalty, complete and attach the form to the corporation's tax return if any of the following apply:

1. The annualized income installment method was used to figure any required installment.
2. The adjusted seasonal installment method was used to figure any required installment.
3. The corporation is a large corporation and Method 2 was used to figure its first required installment.

How to pay estimated tax. Unless you volunteer or are required to make electronic deposits, you should mail or deliver your payment with a completed **Form 8109** to an authorized financial institution or to the Federal Reserve Bank for your area.

Income Tax Returns This section will help you determine when and how to report your corporation's income tax.

Who must file. Unless exempt under section 501 of the Internal Revenue Code, all domestic corporations (including corporations in bankruptcy) must file an income tax return whether they have taxable income or not.

What form to file. A corporation must generally file **Form 1120** to report its income, gains, losses, deductions, and credits, and to figure its income tax liability. However, a corporation may file **Form 1120-A** if its gross receipts, total income, and total assets are each under $500,000 and it meets certain other requirements. Also, certain organizations must file special returns. For more information, see the instructions for Forms 1120 and 1120-A.

When to file. Generally, a corporation must file its income tax return by the 15th day of the third month after the end of its tax year. A new corporation filing a short-period return must generally file by the 15th day of the third month after the short period ends. A corporation that has dissolved must generally file by the 15th day of the third month after the date it dissolved.

Example 1. A corporation's tax year ends December 31. It must file its income tax return by March 15th.

Example 2. A corporation's tax year ends June 30. It must file its income tax return by September 15th.

If the due date falls on a Saturday, Sunday or legal holiday, the corporation may file on the next business day.

Extension of time to file. File **Form 7004** to request a six-month extension of time to file a corporation income tax return. The IRS will grant the extension if you complete the form properly, file it and pay any balance due by the due date for the return for which the extension applies.

Form 7004 does not extend the time for paying the tax due on the return. Interest will be charged on any part of the final tax due not shown as a balance due on Form 7004. The interest is figured from the original due date of the return to the date of payment.

For more information, see the instructions for Form 7004.

Penalty for late filing of return. A corporation that fails to file its tax return by the due date, including extensions, may be penalized five percent of the unpaid tax for each month or part of a month the return is late--up to 25 percent of the unpaid tax. If the corporation is charged a penalty for past due payment of tax (discussed next) for the same period of time, this penalty is reduced by the amount of that penalty. The minimum penalty for a return that's over 60 days late is the smaller of the tax due or $100. The penalty will not be imposed if the corporation can show that the failure to file on time was due to a reasonable cause. Corporations that file late must attach a statement explaining the reasonable cause.

Penalty for overdue tax payment. A corporation that fails to pay the tax when due may be penalized ½ of one percent of the unpaid tax for each month or part of a month the tax is not paid, up to a maximum of 25 percent of the unpaid tax. The penalty will not be imposed if the corporation can show that the failure to pay on time was due to a reasonable cause. However, this penalty does not apply to past due payments of required installments of estimated tax.

Trust fund recovery penalty. If a corporation doesn't withhold, deposit or pay to the U.S. Treasury the income, social security, and Medicare taxes that must be withheld from employee wages, the trust fund recovery penalty may apply. The penalty is the full amount of the unpaid trust fund tax. This penalty may apply to you if these unpaid taxes can't be immediately collected from your business.

The trust fund recovery penalty may be imposed on all persons who are determined by the IRS to be responsible for collecting, accounting for, and paying these taxes and who acted willfully in not doing so.

A responsible person can be an officer or employee of a corporation, an accountant or a volunteer director/trustee. A responsible person also may include one who signs checks for the corporation or otherwise has authority to cause the spending of business funds.

Willfully means voluntarily, consciously and intentionally. A responsible person acts willfully if the person knows the required actions are not taking place.

Tax Deductions & Selected Business Expenses

In managing an active corporation, it's important to be familiar with all aspects of how a corporation works. Part of that management responsibility involves being familiar with business expenses. Understanding which expenses are deductible and which are not is important. By familiarizing yourself with all legal business expenses, you can dramatically reduce your corporate taxes and get more personal tax-free perks. Rules on income and deductions that apply to individuals also apply, for the most part, to corporations. However, some of the following special provisions apply only to corporations.

Car Mileage. 57.5 cents per mile is the current rate that a business can reimburse an individual for using a personal vehicle for business purposes. This is not considered income to the individual. (NOTE: An alternative to this is to rent a car to the corporation. This is a way of drawing funds out of a corporation without employee taxes or self-employment taxes being paid on rental income).

Automobile Lease Program. This is for expenses related to vehicles leased by the corporation.

Meals and Lodging. Generally, you can deduct the costs of these as long as the expense is an ordinary and necessary business expense. Regular business meals are now only 50 percent deductible.

Education Expenses. A business can fully deduct educational expenses for employees if the education is job-related.

Employee Health Insurance. Generally speaking, any expenses an employer incurs related to health insurance (for employees or for dependents) are 100% tax-deductible as ordinary business expenses, on both state and federal income taxes.

State Income Tax. If a corporation has to pay state income tax, this is a deductible item. However, if the business is a Nevada corporation, there's no state income tax.

Childcare. You can pay up to $5,000 annually for an employee's childcare without considering it income to the employee. (This is not an option for individuals who are contractors of a corporation).

Below-Market Loans. A below-market loan is a loan on which no interest is charged or on which interest is charged at a rate below the applicable federal rate. A below-market loan is typically treated as an arm's-length transaction in which the borrower is treated as having received both:

- A loan in exchange for a note that requires payment of interest at the applicable federal rate
- An additional payment

Deciding on whether to treat the additional payment as a gift, dividend, contribution to capital, payment of compensation, or other payment, will depend on the substance of the transaction.

Capital Losses. A corporation can deduct capital losses only up to the amount of its capital gains. In other words, if a corporation has an excess capital loss, it cannot deduct the loss in the current tax year. It can, however, carry the loss to other tax years and deduct it from capital gains that occur in those years.

First, you'll want to carry any net capital loss back three years and deduct it from any total net capital gain that occurred in that year. If you don't deduct the full loss in the third year back, you move the remainder forward one year to the second year back and then any remainder beyond that forward to last year (one year back). If any loss remains, you can then carry it forward to future tax years, one year at a time, for up to five years. When you carry a net capital loss to another tax year, you simply treat it as a short-term loss. It doesn't retain its original identity as long-term or short-term.

Example. A calendar-year corporation has a net short-term capital gain of $3,000 and a net long-term capital loss of $9,000. The short-term gain offsets some of the long-term loss, leaving a net capital loss of $6,000. It treats this $6,000 as a short-term loss when carried back or forward.

The corporation carries the $6,000 short-term loss back three years to 1996. In 1996, the corporation had a net short-term capital gain of $8,000 and a net long-term capital gain of $5,000. It subtracts the $6,000 1999 short-term loss first from the 1996 net short-term gain. This results in a net capital gain for 1996 of $7,000, consisting of a net short-term capital gain of $2,000 ($8,000 - $6,000) and a net long-term capital gain of $5,000.

S corporation status. A corporation may not carry a capital loss from or to a year in which it was an S corporation.

Rules for carryover and carry-back. When carrying a capital loss from one year to another, the following rules apply.

- When figuring this year's net capital loss, you cannot use any capital loss carried from another year. In other words, you may only carry capital losses to years that would otherwise have a total net capital gain.
- If you carry capital losses from two or more years to the same year, deduct the loss from the earliest year first. When you fully deduct that loss, deduct the loss from the next earliest year, and so on.
- You cannot use a capital loss carried from another year to produce or increase a net operating loss in the year to which you carry it.
- When you carry back a capital loss to an earlier tax year, you will need to refigure your tax for that year. If your corrected tax is less than you originally owed, you may apply for a refund.

Charitable Contributions. A corporation can claim a limited deduction for any charitable contributions made in cash or other property. The contribution is deductible if made to or for the use of a qualified organization. You cannot take a deduction if any of the net earnings of the organization receiving contributions benefit any private shareholder or individual.

You can ask any organization whether it's a qualified organization, and most will be able to tell you, or you can check IRS Publication 78, *Cumulative List of Organizations*, which lists most qualified organizations. You may find Publication 78 in your local library's reference section.

A corporation cannot deduct more than 10 percent of its taxable income as charitable contributions for any tax year. Taxable income for this purpose is calculated without the charitable contribution deduction.

Taxes and the LLC

When an LLC incorporates, the members must decide how the LLC will be taxed. An LLC with only one member is usually taxed as an individual. An LLC with two or more members can elect to be taxed as a partnership, a C corporation or an S corporation. The type of election determines how the business's capital gains will offset its capital losses.

- **Individual Taxation:** Unless a single-member LLC makes the election to be taxed as a corporation, the IRS will consider the LLC a “disregarded entity.” A disregarded entity is not recognized as being separate from the owner for taxation purposes. In this case, the LLC’s capital gains and losses are treated as though directly incurred by the individual. The capital gains and losses are reported on Schedule D along with any other capital gains and losses. Net capital gains are taxed at the individual taxpayer’s rate. Net losses are deductible up to the IRS limits.

- **Partnership Taxation:** LLCs that choose to be taxed as a partnership will not recognize any profits or losses but pass them through to each partner based on the partner’s ownership percentage. The capital gains and losses will offset each other. The net capital gain or loss is reported on Schedule K of Form 1065, U.S. Return of Partnership Income. A partner’s basis will offset the capital gain up to the basis amount. Each partner will receive a K-1 showing the amount of capital gain or loss that can be deducted on his individual tax return.

- **S Corp Taxation:** LLCs electing to be taxed as S corporations will pass their profits and losses through to the individual shareholders. Any capital gain will be considered a return of a shareholder’s basis in the LLC. The basis will offset the amount of capital gain that’s distributed. The capital gain or loss is reported on the shareholder’s K-1. This amount must be reported on the shareholder’s Schedule D on her individual income tax return. The shareholder can claim the losses, but the amount may be subjected to passive activity loss limits.

- **C Corp Taxation:** LLCs that elect to be taxed as a C corporation are subject to dual taxation. If capital gains exceed capital losses, the net gain is considered ordinary income and added into the LLC’s other income. If capital losses exceed capital gains, the amount is carried back for the previous three years. Any remaining capital losses can be carried forward for up to five years. The LLC pays taxes on capital gains at the corporate rate. Profits are paid out in dividends, and the LLC members will pay taxes on the dividends at their individual tax rates.

Other Deductions Allowed for a Corporation but Not an Individual

Half of FICA at 7.65 percent. (Self-employed individuals can deduct half of their self-

employment taxes – roughly 7.65 – on Form 1040.)

- The 70 percent Dividend Exclusion Rule –allows a corporation to deduct 70 percent of any dividends it earns from unrelated domestic corporations.
- Meals & lodging provided for the convenience of the employer.
- Travel, lodging and meals associated with the director, officer and shareholder meetings.
- Group insurance, which is fully deductible for owners if they are also employees. (Self-employed individuals can deduct 100 percent of their health insurance expenses on Form 1040.)
- All ordinary business expenses for traders of commodities or stocks.
- Employee achievement awards up to $400 value.
- Catered meals.
- Fringe benefits for the officers, directors and shareholders.
- Real estate losses to offset active corporate income.

Start-Up Business Deductions

When you go into business, treat all costs you incur to get your business started as capital expenses. Capital expenses are part of your basis in the business. You recover costs for particular assets through depreciation deductions. However, in most cases you cannot recover other costs until you sell the business or otherwise go out of business. You can choose to amortize certain costs for setting up your business. The costs must qualify as one of the following:

1. A business start-up cost
2. An organizational cost

Start-up costs are costs for creating an active trade or business or investigating the creation or acquisition of an active trade or business. Start-up costs include any amounts paid or incurred in connection with any activity engaged in for profit or to produce income before the trade or business begins, in anticipation of the activity becoming an active trade or business.

A start-up cost is amortizable if it meets both of the following tests:

1. It is a cost you could deduct if you paid or incurred it to operate an existing active trade or business (in the same field).
2. It is a cost you pay or incur before the day your active trade or business begins. Start-up costs can include costs for the following items:
    - A survey of potential markets
    - An analysis of available facilities, labor, supplies, etc.
    - Advertisements for the opening of the business
    - Salaries and wages for employees who are being trained and their instructors
    - Travel and other necessary costs for securing prospective distributors, suppliers or customers

- Salaries and fees for executives, consultants or other professional services

Start-up costs don't include deductible interest, taxes, or research and experimental costs.

Amortizable start-up costs for purchasing an active trade or business only include costs incurred in the course of a general search for or preliminary investigation of the business. Investigative costs are the costs that help you decide whether to purchase the business and which business to purchase. Costs you incur in the attempt to purchase a specific business are capital expenses, and you cannot amortize them.

If you completely dispose of your business before the end of the amortization period, you can deduct any remaining deferred start-up costs. However, you can only deduct these deferred start-up costs to the extent they qualify as a loss from a business.

You can amortize an organizational cost only if it meets all the following tests:

1. It's for the creation of the corporation.
2. It's chargeable to a capital account.
3. You could amortize the cost over the life of the corporation if the corporation had a fixed life.

You must have incurred the cost before the end of the first tax year in which the corporation was in business. A corporation using the cash method of accounting can amortize organizational costs incurred within the first tax year, even if it does not pay them in that year.

The following are examples of organizational costs:

- The cost of temporary directors
- The cost of organizational meetings
- State incorporation fees
- Accounting services for setting up the corporation
- The cost of legal services (such as drafting the charter, bylaws, terms of the original stock certificates, and minutes of organizational meetings)

Costs you cannot amortize. The following costs are not organizational costs and must be capitalized.

- Costs for issuing and selling stock or securities, such as commissions, professional fees, and printing costs
- Costs associated with the transfer of assets to the corporation

How to amortize. You deduct start-up and organizational costs in equal amounts over a period of 60 months or more. You can choose a period for start-up costs that‘s different from the period you choose for organizational costs, as long as both are 60 months or more. Once you choose an amortization period, you cannot change it.

To figure your deduction, you simply divide your total start-up or organizational costs by the months in the amortization period. The result is the amount you can deduct each month. The amortization period starts with the month you begin business operations.

Shareholder costs. Only your corporation can choose to amortize its start-up or organizational costs. A shareholder cannot make this choice. You, as a shareholder, cannot amortize any costs you incur in setting up your corporation. The corporation can amortize these costs.

Depending on whether the corporation is using the cash or accrual accounting method, the tax deduction will be treated differently. Please consult a tax professional for more information on how this deduction is handled.

Income Taxes are Levied by Most States

The following tax charts and information for 2009 are taken from the Tax Foundation website at http://www.taxfoundation.org/taxdata/show/228.html, and the various state sites.

Forty-one states and the District of Columbia allow their courts to be used to collect unpaid taxes of other states. In each case, the right to use the courts of the state depends upon reciprocity – that is, the taxing state must extend like courtesy in its courts. It's not necessary to obtain a judgment in the taxing state before filing suit in any of these jurisdictions:

Alabama, Alaska, Arizona, Arkansas, California, Colorado, Connecticut, Delaware, D.C., Georgia, Hawaii, Idaho, Illinois, Indiana, Iowa, Kansas, Kentucky, Louisiana, Maine, Maryland, Massachusetts, Michigan, Minnesota, Mississippi, Missouri, Nebraska, New Hampshire, New York, North Carolina, North Dakota, Ohio, Oklahoma, Oregon, Rhode Island, South Carolina, South Dakota, Tennessee, Vermont, Virginia, Washington, West Virginia or Wisconsin.

Chapter 9: What's The Next Step?

What's the mission of NCH.? Simply put, "We Launch Businesses and Protect Wealth." We accomplish this mission daily, and in several arenas. From the infancy of your company and its formation, to ensuring privacy and separation between corporate and personal assets, to helping you build business credit and file taxes, NCH will be by your side.

NCH built its foundation on entities, and it will continue to be the leader in entity formation. Whether you need a limited liability company or corporation, speak to one of our accomplished corporate analysts to find out how NCH can help get your business off the ground. No matter what type of business you have, from brick and mortar to real estate investing, to a solely online store, NCH can provide you with tools to successfully launch and grow your enterprise.

In addition to entity formation, NCH can help you organize your personal assets and prepare your estate with long-term planning, utilizing revocable living trusts to secure your future. We don't stop there … whether you need guidance from a corporate coach, help with taxes and accounting, education on building business credit, or reestablishing your retirement as a self-directed account, we're here.

There are several steps that you can take to protect assets, create privacy, and maintain separation between your professional and personal life. Putting these pieces together with a plan that benefits you, both in the present and for the future, will take the savvy entrepreneur beyond beginner steps and into the realm of creating a solid business with complete protection.

Contact NCH at 1-800-508-1729 to learn more!

A Quick Guide

Let's do a simple review, starting with taxes … NCH possesses the expertise to help business owners navigate the tricky waters of business taxes. And, the state of Nevada offers an unparalleled list of tax benefits that will work within the confines of state law around the U.S. - even in your state.

These advantages include a great list of "Nos" that the state of Nevada has:

- No personal income tax
- No estate or gift tax
- No admissions tax
- No franchise tax on income

Nice, right?

Now let's move on … what about that ever-present threat of a lawsuit? As we've pointed out throughout this book, litigation is an ever-growing issue for business owners and investors. But lawsuits can be discouraged, and NCH can help you accomplish that task.

In the state of Nevada, when we talk about a Limited Liability Company, it really is that – a company where liability truly is limited to the business. Sure, there will always be threats, and as previously discussed, the remote possibility that the “corporate veil” could be pierced. But avoid the pitfalls of comingling your personal and business dealings and assets, and that threat is severely reduced.

NCH can show you how! Call us at 1-800-508-1729.

Without the ability to reach personal assets, a Nevada LLC offers potential plaintiffs only one option should they ever win a lawsuit and receive a judgment. A winning plaintiff can get a “charging order” against your LLC. (Managers and officers of an incorporated entity – and the LLC is one just like a corporation – are not held personally liable for the debts of the company, unless there’s a case of outright fraud or you've signed a personal guarantee.) A charging order, you might know or remember, does put a lien against the assets of the LLC that lost the suit. But until those assets are liquidated, or the members of the LLC are distributed funds out of the company, the judgment gained cannot be collected and will just sit there unfulfilled. Since the majority of plaintiff's attorneys in personal injury cases work on contingency (you've seen the ads and billboards - “We don't get paid unless you get paid”), think about how much this “charging order” protection reduces the number of lawyers out there willing to take a case involving your Nevada LLC that NCH will have formed for you?

Yeah, it reduces it by a lot! And this protection travels with you into whatever state you live and do business.

In addition, unlike so many other states, Nevada doesn’t require an LLC to publish a list of its assets in the public record. So, even for those attorneys willing to take the case, they have to figure out what’s available to collect upon during the discovery phase of a case. That means spending money for depositions and searches, not knowing if there’s even anything to take on the other end. It’s possible that a third-grade teacher on the other side of the country could have millions tucked away in private businesses, stocks, bonds, mutual funds, and other assets in a Nevada LLC.

Or … that same teacher's LLC could have absolutely NOTHING!

Think of the level of privacy that one omission from public records affords. But Nevada doesn't stop there.

To sum up, a Nevada incorporated entity gives you:

- Tax advantages
- Security advantages
- Privacy advantages
- Legal advantages

And really, we've just scratched the surface of the “Nevada Edge.” Contact NCH at 1-800-508-1729 and let us show you how we can help you and your business!