

THE COMPLETE LLC BEGINNER'S GUIDE

THE EASY WAY TO CREATE & MANAGE YOUR
LIMITED LIABILITY COMPANY, SAVE ON TAXES,
& AVOID COSTLY MISTAKES

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INTRODUCTION: START YOUR BUSINESS WITHOUT THE STRESS

Being a business owner is an exciting prospect. When you own a business, you get to share your products or services with the world on your own terms. Sure, being a business owner can be hard work, especially at the beginning, when you're trying to build a brand, find reliable employees, and establish yourself as a trusted authority in your field.

As if that weren't stressful enough, it's a litigious world out there. Although you want your name to be synonymous with the excellence of your products and services, you don't want it tied to your personal assets if something should go wrong. Business insurance is a tremendous thing, but if you really want to protect yourself, your business, and your assets, then consider creating your new enterprise as an LLC, or limited liability corporation.

LLCs don't exist solely to protect your assets. There are many other reasons to establish an LLC, which we will discuss in this book. But you may want to know what my expertise is on the subject.

MY STORY: WHY I STARTED AN LLC

I started my first ecommerce business about eight years ago. I wanted to protect myself individually, but also have my finances, taxes, and everything else separate from the start. I scoured the

internet to figure out how to start an LLC and piecemealed the process together. It took me forever to figure it out and I remember being nervous because I wasn't sure it was done correctly and didn't want to get into any trouble with the government or have anything come back to bite me financially. When eventually I closed that company, I had no idea what to do or how to dissolve it. I just kind of let it float away from me, hoping I wouldn't get in any sort of trouble. I wish I had a step-by-step process to follow that would have given me the peace of mind that I was setting my business up correctly.

A few years later, my wife and I got into real estate investing and started an LLC for that company. I was more confident this time around, given I'd formed an LLC before, but again, I wasn't sure it was done right. So, I went back to the internet to try to figure it out, submitted all of my forms, and held my breath.

Finally, we started a third LLC for another company we started, but this time we took a different approach. We were overwhelmed by the idea of running and operating two different LLCs (that we weren't even confident had been established correctly), plus an S Corporation that we own, so we looked into more advanced options. Not to mention we had some unfinished business with the ecommerce business I left by the wayside, as well as another LLC my wife had before we were married!

We decided on two things. First, we were going to clean up our mess and get organized. Second, we were going to ensure that everything was set up 100% correctly from the start with our new company and get the real estate LLC up to snuff. In the end, after a ton of research that just led to more questions, confusion, and uncertainty, we decided we wanted to nest our LLCs under a holding company, so we hired a company to help us get it right the first time.

What is a holding company and why did we start one? A holding company is a separate legal business entity that owns a controlling interest in another company (or companies), known as a "subsidiary." These are also sometimes referred to as parent companies that own and control multiple companies. There are many reasons to start a holding company, but it is not necessary for everyone and may not be applicable in your situation. We decided to start one for extra liability

protection, simpler business management, the opportunity for lower financing costs, and estate planning purposes.

With the help of professionals, we started our holding company then our new LLC, and ended up creating another real estate LLC. Why did we do that? Because we decided we wanted all of our companies to be in a state where we, the owners, along with our personal information, could remain anonymous. There are a few states that do this, but Wisconsin (our home state) is not one of them. Long story short: we started our holding company, a new LLC, and a real estate LLC in another state with better privacy laws, and deeded our Wisconsin real estate LLC into the new out-of-state LLC. The best part is we are confident everything was done correctly, which gave us tremendous peace of mind and clarity.

What we learned, though, is that it's really not as complicated of a process as it seems (I can feel your stress levels going up just reading my story!). Our journey is somewhat complicated but the average person should have no trouble starting an LLC with the confidence they are doing it correctly without paying a company or professional for help, and without needing a law degree to understand all that is required.

That's why I decided to write this book: to help everyday people start their businesses off on the right foot. You have way more to do than worry about paperwork when starting your business. I get it – my wife and I are both entrepreneurs. What gets us excited every day is not business entity formation, but growing our businesses, building wealth, and the future we dream about for our family. We want to help you do that too. Unfortunately, getting all of our legal ducks in a row is a necessary part of a thriving business. So, although it can be boring and a bit mundane, we hope to help get you through the process as quickly and smoothly as possible so you can be confident your foundation is set and move on to what matters most.

Now, let's talk about you.

We'll explore the types of LLCs, the tax implications of having an LLC, and the regulations and record-keeping aspects of LLCs, and also walk you through the steps of setting up an LLC and dissolving one. Along the way, you'll learn all the ins and outs of daily, monthly, quarterly,

and yearly operations to prepare you for everything that comes with being part of an LLC.

In this book you'll learn the amazing benefits of an LLC, which include flexibility, manageability, and transference, and the details and tips you need to know to handle your business's long- and short-term obligations and operations. If you're ready to learn, and eager to be part of the exciting world of business ownership, let's get started!

PART ONE
**EVERYTHING YOU NEED
TO KNOW TO CREATE
YOUR LLC**

CHAPTER 1

WHY START AN LLC?

"My best advice to entrepreneurs is this: forget about making mistakes, just do it."

~ Ajaero Tony Martins

Starting a business can be both exhilarating and terrifying. The terror is usually focused on making mistakes like setting up the business the wrong way and then being hit with absurd taxes and/or putting your personal assets at risk.

Before we do a deep dive into LLCs, I'd like to offer this bit of wisdom that may help ease the beginner's jitters: rookie mistakes happen, but after you read this book, you will know the ins and outs of LLCs, whether they're right for you, and how to set one up.

By its nature, an LLC offers limited liability protection and it's important to know exactly what it does before you start one.

My aim is to help you set up your fledgling LLC so your business hits the ground running – and keeps on running smoothly. Not all lessons have to be hard! We'll begin this lesson by answering two very important questions: What is an LLC, and is an LLC right for you?

Let's begin!

WHAT IS AN LLC?

LLC stands for Limited Liability Company. This is a type of business that takes the freedom and perks of a self-owned business and combines it with limited liability protection, much like that of a corporation.

This means that instead of being liable at great personal risk if something happens with the business, you and your assets are protected. If the business is sued, you and any other individuals who own the LLC would not be sued personally and would not have to worry about losing personal assets.

Before we get into how an LLC functions, let's look at why it exists in the first place: the security of limited liability protection.

WHAT DOES LIMITED LIABILITY PROTECTION MEAN?

LLCs are formed in order to protect personal assets from the debts or judgments the business may incur. Only the LLC would be liable in the event of a lawsuit, not its members (co-owners). However, its protection is not complete (hence the term "limited"). Be sure to check with your state's regulations and read on to discover what is or isn't protected.

Let's discuss the protections that LLCs offer, and what they don't protect.

Protection Against Personal Liability for Business Debts

If the LLC can't pay its debts, you are not personally liable. Creditors can go after the business bank accounts, property, and other assets, but not the personal assets of the members.

However (there's always a "however"), many creditors will demand personal guaranties up front when you're obtaining business loans or business credit cards. If your name is on that guaranty, you are liable for that debt. Because all members would typically sign these guaranties, everyone would be partially liable for the debt should the LLC default on a loan.

Protection Against Personal Liability for the Actions of LLC Members/ Employees

This protection applies in all states. LLC owners are personally protected from any wrongdoing or negligence by other members (co-owners) or the company's employees during the course of doing business; only the owner(s) or employee(s) involved in wrongdoings would be personally liable.

For example, if an employee shows up to work drunk and causes a car accident while making a delivery and the other person involved in the accident is seriously hurt, the LLC will likely be sued and found liable for the negligence of its employee. While the LLC's assets can be seized, the owners would not be held personally liable and would not have to pay any judgments against the LLC.

WHAT DO LLCs NOT PROTECT AGAINST?

Let's look at the "limited" part of an LLC's protection – specifically, what you as an LLC owner do inside and outside of the business.

Personal Liability for Your Own Actions

All states feature this exception. You are always personally liable for any wrongdoings committed during the course of business. This includes your negligence that causes injury or property damage, as well as tax and other types of fraud. Say you fail to implement safety precautions and an employee is injured on the job – you're liable.

Personal Debt

You can't hide behind your LLC if you get into trouble financially. Creditors can't go after LLC assets to satisfy the personal debts of an LLC owner. However, creditors have lots of options to get their money back, and these vary depending on the state.

These include obtaining a "charging order," which forces the LLC to pay the creditor the money through foreclosing on the individual's LLC membership/ownership interest. In this scenario, the creditor becomes a part owner of the LLC and enjoys all of the former member's financial rights, including a percentage of the profits; the creditor can also sell the shares to satisfy the debt.

Creditors may also take the drastic measure of a court order to dissolve the LLC and then garnish the offending member's share.

State laws vary but the short story is, if you are in debt personally, creditors will find a way to get their money through your LLC. The LLC's assets are not protected from your personal debt!

Now that you know what protections are offered by forming an LLC, let's look at the pros and cons of this business model.

PROS OF AN LLC

There are quite a few pros to having an LLC, from personal convenience to cost-effectiveness to protection. Let's take a deep dive into some of the most important benefits that an LLC can provide its members:

Protection of Personal Assets

Structuring a business as an LLC protects you and your assets from debt, lawsuits, and other liabilities. This liability protection is limited, as we've discussed above, but in general, if everyone acts ethically, your assets are protected.

Flexible Management and Ownership Rules

LLCs provide broad flexibility in the structuring of management and ownership for the business. Members can choose to manage the company themselves (member-managed) or designate specific individuals to run the business (manager-managed).

Ownership percentages and profit shares can be tailored according to the contributions, agreements, or other criteria set out in the LLC's operating agreement. Unless the state laws regarding LLCs are broken, almost anything placed in an operating agreement can dictate how things function within the business.

Flexible Tax Status

LLCs offer flexibility in taxation. LLCs are treated as "pass-through" entities, meaning profits and losses are passed through to the individual members' tax returns. However, LLCs have the option to elect to be taxed either as a C corporation or an S corporation (which we'll discuss later), if this structure benefits their unique situation. This tax flexibility allows members to optimize their tax planning, as one size doesn't fit all.

LLCs also provide flexibility in tax planning. You can take advantage of deductions, credits, and other tax strategies to minimize your

overall tax burden. Furthermore, you can distribute profits among members in a tax-efficient manner based on their individual financial situations. Be sure to consult with a tax professional about the implications of an LLC for you and your business.

Flexible Profit Distribution

An LLC offers flexibility in profit distribution to its members. Unlike some other business structures where profit-sharing is strictly tied to ownership percentages, LLC members can choose to distribute profits based on other criteria as long as those criteria are clearly outlined in the operating agreement. This flexibility allows for the creation of profit distributions that meet the unique needs and contributions of each member. It's an advantageous situation in the case of unequal financial or sweat equity contributions, and will prevent future disputes as long as everything is spelled out crystal clear in the operating agreement.

Flexible Operations Structure

Creating an LLC is often the ideal solution for small businesses, startups, and family-owned businesses. An LLC provides a simple and flexible structure for business operations and offers limited liability protection to the members. The operating agreement clearly states the LLC rules (agreed upon by all members), which virtually eliminates disputes regarding ownership shares and responsibilities.

Simplified Influx of Capital

One thing not as commonly understood about an LLC is that it can also be a way to obtain capital for your business. With the flexible rules regarding ownership and operations, members can vote at any time to add new members to introduce fresh financial contributions that can invigorate a struggling business, or scale an already successful business.

Optimized Real Estate Investments

Many real estate investors use LLCs to hold and manage their properties. LLCs offer liability protection, tax benefits, and flexible ownership structures that are beneficial for real estate investors. An LLC can also make it easier (and safer) to pool resources with other investors, adding layers of protection for high-risk investments or different scenarios involving various types of properties.

Simplified Estate Planning

An LLC can be a valuable tool in estate planning, whether you're using a regular LLC or a family LLC. You can transfer ownership interests in the LLC to your heirs or beneficiaries as part of your estate plan or create an LLC to handle assets after you've passed away. This allows for smooth transitions and potentially avoids probate and other complications for your beneficiaries.

Protection of Intellectual Property

Many creative individuals don't properly address the importance of safeguarding their intellectual property (IP). They often put their own names on the application for patents, trademarks, or copyrights, thinking that this will ensure that they themselves are the rightful owner. Well, yes...except that this can backfire. An author of a book will copyright it as soon as it has been written. Say a movie producer picks up the story and it's made into a movie. Now, you need to manage two different revenue streams (a tough problem to have, I know). If the LLC (rather than you) "owns" the copyright, you may enjoy tax benefits as well as personal protection if someone comes forward and says you plagiarized their work.

An LLC can help protect not only your IP but your personal assets if there's ever a dispute like trademark, patent, or copyright infringement.

There are a couple of things to consider. If you leave the LLC, the IP stays with the LLC, making your exit cleaner. You will need to negotiate and get legal counsel if you want to take your IP with you and place it into another LLC. If you want to attract investors or want to sell the company, the IP will increase the company's overall value.

Tip: Form an LLC *before* you apply for a patent, trademark, or copyright. Then, assign the exact name of the LLC as the owner. It's important to use the exact name. For example, if your LLC is called "Smith Consulting," you have to remember to add LLC at the end ("Smith Consulting, LLC") because that is the legal entity, whereas simply Smith Consulting is not. This is a mistake that is extremely difficult to correct, and possibly irreversible.

A Solution for Short-Term Projects

LLCs are not limited to long-term businesses. They are also suitable for short-term projects, joint ventures, or collaborations, such as a real

estate development project. Independent contractors also benefit from operating as an LLC. You can form an LLC specifically for a particular project, allowing for shared ownership, liability protection, and clear management for the duration of the project, and then easily dissolve the business once the project is complete.

Asset Segregation

An LLC allows you to segregate assets and liabilities. This means you can establish separate LLCs for different business endeavors or assets. Each LLC operates independently, and its liabilities do not typically extend to the assets of other LLCs. This segregation can provide added protection and organization, especially for business owners with multiple ventures.

For example, Rita is the owner of a very multi-faceted business that offers several types of services. Instead of lumping all of her services under one company, she has created LLCs for each one: her legal firm; her real estate investing service; her wealth management consulting service; her financial and career counseling service for Black and other minority women; and her business consulting service for minority-owned businesses. Each business is a separate entity and operates as a distinct business. Rita has set each of these up as individual SLLCs (Series LLCs), which we'll go into shortly. This is a type of LLC that is more advantageous to people who operate different types of businesses.

CONS OF AN LLC

Though there are many benefits to an LLC, there are a few cons that are worthy of consideration before you sign any paperwork. Let's take a closer look at why starting an LLC isn't right for everyone.

The Illusion of Total Protection

It's important to note that there is a concept referred to as "piercing the LLC veil," in which members of an LLC can personally be held legally liable, thus voiding this protection. This is a very rare occurrence, however, and generally happens when members are engaged in fraudulent or illegal activities and/or have broken statutes pertaining to the requirements of an LLC. Some individuals or businesses may misuse the LLC structure to engage in fraudulent or unjust activities, such as evading taxes, engaging in fraudulent business practices, or hiding assets. While an LLC is a legitimate business structure, such misuse

can lead to legal consequences and negate the protection it offers. As long as everyone operates ethically, you're almost guaranteed safety.

Another issue can "pierce the veil": failing to separate yourself from your business. Businesses are professional entities and therefore require professional actions and formalities. They must be kept separate from personal affairs and finances. If you fail to keep your personal and professional doings separate, you open yourself up to the issue of piercing the veil. It's essential to treat your LLC as a separate entity, including keeping separate financial records and accounts and not using company money for personal use. If your personal finances mix with professional finances, the courts (and the IRS) are able to treat you and your business as the same entity, voiding the legitimacy of any liability protections an LLC provides.

Additional Work and Complexity

There's a level of complexity and effort required to create and maintain an LLC as opposed to a simple partnership. The initial work of setting up an LLC centers around creating a bombproof operating agreement. This is where everything is outlined. I like to compare it to the U.S. Constitution, where guidelines are set forth regarding membership/ownership and operations. Without this document, all hell could break loose if there's ever a dispute. We'll go into the nuances of creating an operating agreement shortly. For now, know that while it takes time and effort to create this document, the benefits will become apparent anytime the LLC wants to add members, members wish to leave, there's a transfer of shares, or in the case of disagreements.

For the most part, LLCs are advantageous. LLCs are not ideal if someone wants to hide shady deals behind company dealings, treats the business as an extension of their body, or fails to draw up a comprehensive operating agreement.

TYPES OF LLCs: ONE SIZE DOES NOT FIT ALL

Now that you know what protections an LLC offers, as well as its pros and cons, let's discuss the various types of LLCs and their intended purposes.

There are different types of LLCs, each with different intentions. Most types of LLCs fall under the umbrella of multi-member LLCs, though some of the examples below can be operated as single-member LLCs.

Single-Member LLC

A single-member LLC (SMLLC) is an LLC with only one owner, or member. The purpose of this LLC is typically centered around personal liability protection, as well as protection of intellectual property.

The limited liability given to the sole owner of an SMLLC is vital for protecting that person's personal assets. Some business owners make the mistake of allowing their company to be intertwined with them. It's often easy to see a person and their business as one entity, so this level of protection is key. The owner has to be careful that they actually keep themselves separate, or this protection becomes null and void.

Here's where it gets a little confusing. At the same time as the business owner enjoys this limited protection, he or she can also claim business contributions, expenses, and income on their personal taxes. When doing taxes, the IRS refers to this type of LLC as a "disregarded entity," given the LLC and the individual are handled on the same tax return as opposed to separate ones. On the plus side, this designation simplifies the tax process. There is a downside to this, however. As both employee and employer, the owner of an SMLLC must pay both types of taxes like anyone who is self-employed. That's why working with a tax professional is essential.

There is a great level of flexibility and ease with an SMLLC. It allows you to run things in a structured way that follows guidelines and offers protection while still leaving room for your own unique management style. With only one member, there are no negotiations about who will contribute what or how things will be handled.

There's also less need for an operating agreement, as everything falls to the single member. I still recommend creating one to distinguish yourself from your business, simplify operations, and potentially prepare the LLC to bring on additional members in the future.

Multi-Member LLC

A multi-member LLC (MMLLC) is an LLC with two or more members. This type of LLC also protects each member from liability. This protection typically matches their level of investment and contributions to the LLC.

Another benefit of an MMLLC is that the burden of work, as well as finances, can be split between members. Contributions, allocations, and distributions are decided by the members. This structure leaves

room for additional investments from new members if the business needs a cash infusion. It also allows for more of a team-like running of the business so that things can operate smoothly and efficiently without anyone being overworked.

A well-written, comprehensive operating agreement is an essential element of an MMLLC. Due to the extra moving parts and responsibilities, there's always the possibility of disputes, misunderstandings, and mistakes. If there are no guidelines on how to resolve the issues, the company could risk getting bogged down in interpersonal issues. An operating agreement that clearly states everyone's roles and responsibilities, along with contributions and disbursements, will save a lot of headaches, arguments, and time later on.

Unlike single-member LLCs, MLLCs can be taxed in two different ways. Depending on how the LLC operates and the preferences of the members, the LLC can be taxed as a corporation or a partnership. Work with a tax professional to ensure the most advantageous tax situation for a MLLC.

Professional LLC

A professional LLC is an LLC created by a professional who may face liability in their work. Examples include medical professionals, lawyers, architects, real estate developers, and engineers.

This type of LLC is often called a professional limited liability company (LLP) and provides protection from liability for the professionals themselves, keeping them and their assets safe from most malpractice issues. It's important to note that the scope of a professional LLC varies depending on the profession, as well as the state where the professional works. If the professional travels to other states to do work, they may need to take extra steps such as filing LLC paperwork in the states they operate in. For peace of mind, I recommend consulting with an attorney experienced in professional LLCs.

Series LLC

A series LLC (SLLC) allows for multiple individual LLCs to be created within a "master" or umbrella LLC. These mini-LLCs operate as separate entities. Each SLLC has a different name, separate bank account, different management/employees and operations, separate contracts, and separate record-keeping. Membership interests, operations, and assets and liabilities are completely separate. Each one operates and

conducts business completely independently of each other. Each entity can sue or be sued without affecting the other SLLCs.

In a way, SLLCs are like subsidiaries of a corporation. The main reason for creating one is that liability risks are limited to individual LLCs within the series and don't affect the others. As a bonus, there's a lot less cost to set up additional legal entities within the series: there's just one formation filing fee, even if you own five LLCs like Rita in the example above. As a side note, Rita is the sole member of each LLC in the series.

SLLCs can benefit anyone like Rita who operates different yet interrelated businesses, franchisees who have multiple locations, or real estate investors with multiple properties. There are no repercussions to the "master LLC" if a high-risk real estate investment fails, or if one franchise underperforms franchises in other locations; only those individual LLCs are affected.

Family LLC

A family LLC is an LLC made up of family members who are legally related through birth, marriage, or adoption. These are most commonly utilized if there is a family business owned by multiple family members or in estate planning.

A family LLC provides protection for each family member from liability, as well as from issues like a fellow member's debt or legal issues. Apart from the family aspect, this type of LLC generally runs similarly to a multi-member LLC. We all know that family relationships can be strained any time money is involved. A family LLC can help protect family members financially and also protect relationships. With a clear operating agreement, this type of LLC keeps arguments to a minimum, as members are legally contracted to follow the agreement they've signed.

In the case of estate planning, a family LLC can be created to control and safeguard a person's assets after the person has passed away. This type of LLC allows the assets to remain in the family, gives tax breaks to the family members within the LLC regarding those assets, and often helps minimize disagreements. The most typical type of family LLC for estate planning is when surviving members are left a property or group of properties.

Low-Profit LLC

A low-profit LLC (or an L3C) is created for educational businesses or charitable organizations. For an LLC to qualify as a low-profit LLC, the primary mission of the business needs to be linked to benefiting society in some way alongside making a profit, as opposed to a 501(c)3, which is a not-for-profit organization. Notably, an L3C can't have any link to politics or legislation.

As of 2024, not all 50 states recognize this type of LLC. If you're interested in a low-profit LLC, you'll need to look into your state's statutes. Sometimes there are loopholes by including other states within your LLC, so it might be worth speaking with an attorney within your state who specializes in LLCs.

It's important to note that each type of LLC is affected by a state's laws in different ways. Once you choose your type of LLC, take a close look at what the state statutes are regarding that specific type.

HOW AN LLC WORKS

Next, let's look at some key terminology that helps you understand how LLCs work. In short, owners — called members — own a percentage of the LLC, usually based on their contribution. They are then allocated a percentage of the profits or losses, and those proceeds are distributed according to the ownership percentage. Let's dive in!

Ownership

The owners of an LLC are called members. Only members, not outside stockholders or shareholders, own interests in the company. These interests can be divided into whatever percentages the members agree on and are not required to be equal. Usually, ownership percentages are based on how much each owner contributes to the LLC, either financially or in sweat equity.

Members of an LLC are similar to shareholders of a company in that they own part of the company, but unlike shareholders, they often have a hand in management and daily operations. The rules of membership are outlined in detail in the LLC's operating agreement.

LLC members are entitled to a share of the company profits, but they also often participate in the operation and management of the business. Or, the members may opt to hire a manager to run the LLC. Managers do not have voting rights and do not receive membership

interest; they are salaried employees whose role is to oversee the operation and management of the company.

The owners' membership interest is not based on the number of shares a person owns; instead, a person invests money, property, or sweat equity into the business and receives an ownership interest based on the amount of their investment. There usually isn't a limit on how many members an LLC can have, with one being the minimum.

When an LLC is created, the members draft an operating agreement that delineates a clear structure of ownership and management so that all rights, responsibilities, ownership details, and rules of the LLC and the members within it are indisputably defined. This agreement will outline (among other things) contributions, allocations, distributions, and the rules of governing.

One of the perks of an LLC is that ownership is very flexible and can be transferred easily. If it's a multi-member LLC, members will vote on whether they approve the transfer.

Contributions

Contributions to the LLC refer to the funding behind the business; but also less clearly defined contributions like sweat equity that benefit the company. Contributions can be in the form of liquid money, labor, or assets like real estate, equipment, or intellectual property.

Contributions give the members of the LLC a right to own membership interest in the company. Ownership percentages are often based on the contributions of each member. Most often, those who contribute more to the LLC will own more interest in it.

While upfront contributions are necessary to get an LLC started, sometimes ongoing financial contributions are also needed. This is especially true at the beginning of an LLC when the business is trying to get off the ground (many companies operate in the red for the first year or two). If ongoing contributions are expected, these expectations must be outlined in the operating agreement so that all members are legally required to adhere to their obligations, and everyone's interests are protected.

Many LLC owners find that it's not initial contributions that cause disputes, but the ongoing ones. The operating agreement should outline particular circumstances that will require members to comply with potential future contributions. For example, if the LLC is about to

go belly up, each member may be required to contribute a certain amount of money to keep it afloat.

I want to emphasize again, it's not the initial contributions that cause disputes; it's what happens down the road if the company requires an additional influx of cash. There can also be disputes as to what someone's contribution is worth, for example, if they contribute their time and efforts rather than cash. Lay these expectations out initially and save a lot of headaches later.

Allocations

Understanding allocations will help you understand how the LLC income is handled and how the LLC is taxed.

An allocation is technically a distribution of profits or losses. Allocations refer to the particular distribution of a percentage of the LLC's profits or losses agreed upon within the members' ownership agreement. Many LLCs are considered equal partnerships, in which case allocations would be divided equally. Unequal allocations must be clearly defined in the operating agreement.

The percentage of profits and losses will be allocated to the members of the LLC for their individual tax purposes, whether they take that percentage as personal income from the LLC or they decide to keep it in the business.

For example, if you and your business partner create an LLC with 50% ownership each and the company profits \$10,000 in a year, you will each need to pay taxes for 50% of the profit, or \$5,000. This holds true even if one or both of you decide to keep that money in the business or take it as income.

You may be wondering why someone would keep the profit in the business rather than take it out for their personal use. It is profit after all, right? Owners often keep a portion of their allocations in the business to build cash reserves or pay down business debt, and take a modest salary until the business is established and fully profitable. Whether you take the profit from the LLC as personal income or keep it in the business, you have to pay taxes on your percentage that is laid out in the operating agreement.

A member's allocation does not necessarily have to match their ownership percentage like in the above example, but many people who

create LLCs find this a fair and easy way to decide on allocations. Allocations should be clearly outlined in the operating agreement.

Distributions

We've established that you have to pay taxes on the amount of the LLC's income that is allocated to you. You will then receive the remaining after-tax amount in the form of a distribution. In the context of an LLC, a distribution is the cash or assets that are paid out to its members. It's the actual money that is going into your bank account as a member. These distributions aren't required to be equal to the percentage of a person's ownership, but they often are; distribution percentages are clearly defined in the operating agreement. Work with a tax advisor to avoid any unwanted surprises with the IRS.

Rules of Governing

The rules of governing an LLC vary depending on the state. It's the particular laws or statutes in each state that provide the framework of guidelines an LLC must follow to be legal. These statutes are usually very basic and broad in coverage, as LLCs are meant to be fairly flexible as far as governing is concerned.

Apart from the basic rules a state sets, the rest of the LLC's governance is based on the members, including what each member has a say in or who controls what. In fact, many people refer to the operating agreement as the "governing document" or rulebook for the LLC. As long as the rules don't violate the state laws regarding LLCs, almost anything can be written in this agreement. All members of the LLC must agree on what goes into the operating agreement.

THE MILLION-DOLLAR QUESTION: SHOULD YOU START AN LLC?

Whether or not to start an LLC is an important decision for anyone who has or wants to start a business, needs to protect intellectual property, or wants to become more tax efficient.

As we've covered, LLCs offer:

- Limited liability protection that keeps you and your personal assets safe and shields you from losing everything if your business doesn't succeed

- Flexibility in ownership, management, contributions, distributions, and taxes

However, you need to choose the right type of LLC and structure the LLC in a way that benefits your particular business and your unique needs. Many new business owners find that there are aspects of LLC ownership that are hard to pass up. The high levels of control and protection often offer the best of both worlds, particularly when your business venture is relatively small.

However, they are not for everyone. Ultimately, you need to look at the type of business you're starting, who you want to start it with, how you want this business to be run, and your long-term business goals before choosing the structure that works best.

Who Should Not Form an LLC?

While an LLC offers liability protections that mirror those of a corporation but in a more flexible structure and with less red tape, an LLC may not be needed. In fact, if you are in certain states, the state may not allow you to form an LLC if you are a medical professional, architect, lawyer, accountant, or engineer! In this case, a professional limited liability company (LLP) is an option.

Another reason not to form an LLC for the purpose of asset protection is if you have personally guaranteed a contract or loan. We covered this more in depth previously. If you are banking on an LLC to shield you from business problems, it won't. First, you need very good insurance policies, and then consider the LLC as the second line of defense...never the first.

People who benefit most from forming an LLC include someone starting a business with a partner (their personal assets would be safe from any lawsuits due to wrongdoing on the part of their partners or employees). An LLC may also benefit someone in a risky business such as real estate investment.

An LLC Is NOT ideal for:

- Certain professionals like lawyers, accountants, architects, medical professionals, or engineers. This applies in some states, not all. LLCs generally benefit consultants.
- Someone who carries a lot of personal debt.

- A situation where a business owner needs outside investment but wants to remain the sole owner.
- Someone who doesn't want the additional expense and work involved in forming and operating an LLC (in most states, annual reports and fees are mandatory).
- Someone who can't absorb the cost of paying their portion of the LLC taxes if they did not receive any distributions to pay for that tax bill.
- If you want investors or need to raise capital: some investors will not invest in pass-through companies, while other investors prefer to own stock in a C corp rather than becoming an LLC member, as they can sell the stock easily at any time.

Remember that starting a business as an LLC doesn't mean it's stuck that way forever. You can always shift gears and allow your business to evolve into a different type of corporation if other structures feel more appropriate.

ALTERNATIVES TO LLCs

If an LLC doesn't feel like the best fit for your unique situation, these are some common alternative business structures:

Important considerations include what you want in terms of control and flexibility; the nature of your business; your business goals; how you'd like to manage your business; tax considerations; and liability concerns.

Sole Proprietorship

The main draw of a sole proprietorship is the simplicity that it affords the business owner. It's an easy, inexpensive business structure that allows you to have complete control over your business without too much fuss. You are also allowed to have a more informal business structure and working relationship, as opposed to an LLC. There aren't nearly as many administrative requirements with a sole proprietorship compared with LLCs or other alternatives.

However, sole proprietorship means it's just you (plus employees if you have them). If you want to own a business with another person, this is not an option. You also need to consider issues of liability with a sole proprietorship, which does not afford you the personal asset protections of an LLC. As a sole proprietor, you are liable for anything

that occurs regarding your business. If your business is sued, you can be sued. If your business goes into debt, creditors can come after you and your personal assets. You will be taxed for your income via your individual tax return, as opposed to a business tax return or other options that an LLC provides for taxation, shutting you off from any possible tax benefits you may be afforded as a business in alternative scenarios.

Trade Name, or DBA

There is often confusion about whether a trade name is the same thing as a sole proprietorship or its own legal entity. DBA stands for “Doing Business As.” This means you do business under a business name that is different from yours. For example, Tim Jordan could choose to name his company “Tim Jordan Database Consulting”; or Tim Jordan, DBA Evergreen Database Consulting.”

A DBA is easy to set up and is taxed on the owner’s personal tax returns. *However, a DBA is not a legal entity.* As such, it offers no protection; it’s just a naming strategy. You are still a sole proprietor and there is no personal protection from business liabilities.

S Corporation

An S Corporation, or “S corp,” is a type of corporation that is a “pass-through” entity like an LLC when it comes to taxes, meaning you would not pay federal income tax at the corporate level. Profits and losses are instead reported on individual tax returns. This avoids double taxation, which you will learn more about in the below section on C corps. These corporations also have fewer formalities and reporting requirements; more a sole proprietorship than an LLC.

C Corporation

A C corporation, or “C corp,” is a type of corporation that can have an unlimited number of shareholders with no limitation on the shareholder’s qualities or citizenship. Any business can decide to become a C corp, as there are no restrictions on becoming one, but be prepared for more rules, regulations, and paperwork. This type of corporation is held to a higher standard of formality and regulation. For example, C corps are required to hold regular meetings with shareholders and directors, to maintain detailed and accurate records, and to comply with government rules related to corporations.

One of the perks of a C corp is that there is flexibility regarding how the corporation manages and shares its profits. There are also some tax credits and deductions available to C corps that are not available to other types of businesses. However, these types of corporations are subject to double taxation, as mentioned earlier. The corporation will be taxed at the tax rate for corporations. Shareholders will also be taxed on their personal tax returns when they receive distributions from the corporation.

Limited Partnership

A limited partnership is another type of business structure that is made up of both general partners and limited partners.

General partners are the individuals with a more hands-on relationship with the business. They are involved in how the business is structured and managed. However, general partners are also at risk for personal liability, as there is no protection for them in this type of business structure.

Limited partners are partners who invest capital into the business but are otherwise not involved. These are often referred to as “silent partners” because of their lack of interaction with the business beyond their financial contribution. Due to this separation, limited partners are afforded some protection from liability. The most common limited partnerships are those in investment and real estate ventures or restaurants, as this structure allows people to invest with a reduced risk and no extra time or effort on their part. There are still legal regulations that these partnerships need to follow, depending on the state in which they operate.

COMMON QUESTIONS, MYTHS, AND MISCONCEPTIONS

There are many questions and misconceptions that many new business owners have about forming an LLC. Here’s a quick rundown of the most common FAQs about LLCs.

Q: How do I form an LLC?

A: The bare minimum requirements to create an LLC are to file documentation, obtain an EIN (Employer Identification Number), and register your LLC with the state. Depending on the type of LLC and the state you’re in, there will likely be other steps as well, including

annual fees and reports. We'll go into the "how" of starting an LLC later in the book.

Q: What are the costs associated with an LLC?

A: Each situation is slightly different and there is a variety of factors to consider. Generally, you'll at least need to pay a filing fee when starting an LLC. This fee is a one-time-only amount that is typically under \$100.

Depending on what state your LLC is in, you may need to designate someone to be the "registered agent" for your LLC. This person will be the individual to receive all official documents related to the LLC. Usually, business owners hire a professional to be this person for them. This fee runs from \$100 to \$300 a year.

Other fees may include annual report filing fees, costs of additional licenses and permits, and money paid to professional consultants like attorneys or accountants. This all depends on what state your LLC is in and the specific type and needs of your LLC.

Q: Will my personal assets be protected no matter what?

A: One misunderstanding that many people have when it comes to LLCs is that they provide complete personal asset protection. They do not. As we've covered above, there are holes in this protection that can't be ignored. It's called limited liability for a reason!

Q: Will I receive automatic tax benefits?

A: Though tax benefits are often a perk of starting an LLC, there is no guarantee that forming an LLC will give you or your business any tax advantages. The only tax-related guarantee that an LLC provides is that complying with tax laws is slightly simplified.

Q: Does an LLC give me unlimited flexibility?

A: LLCs provide a lot of flexibility, but that flexibility is somewhat limited, given an LLC is still a structure that is bracketed by state laws and tax regulations. I recommend you keep the word "limited" at the forefront of your decision-making when it comes to the perks, protection, and flexibility offered by LLCs.

Q: Can I skip the legal formalities?

A: Just because you own an LLC where you can write your own rules does not mean that your business is a legal entity unless you register it

with the state and obtain an EIN (at the very least). There are plenty of regulations you'll need to follow in order to maintain its legal status and keep yourself and your business protected.

Q: Are my personal finances automatically separate from my business finances?

A: Just forming an LLC does not automatically separate you from your business. This is especially important in terms of finances. Keeping things separate is the only way to properly protect yourself and your business from liability and legal issues. We recommend consulting with legal and financial professionals who can assist you in ensuring a healthy separation of self and business for the sake of protecting your assets.

DOS & DON'TS OF CREATING AN LLC

Though LLCs are known for their flexibility, there are still plenty of dos and don'ts that you should keep in mind when forming one. Though some of the terminology below may be unfamiliar, we go in depth into these concepts in later chapters.

Dos

Below is a list of the best things to do when forming an LLC. This is not an exhaustive list because the needs of individual LLCs will vary by business type, structure, and state. It's just as important to learn from the "don'ts" that other people have already experimented with on your behalf.

Do Take Your Time to Research and Plan Before Signing Any Papers

A good plan is essential for a successful LLC, and research is essential for a good plan. You'll need to educate yourself on the state-level legal and financial requirements of an LLC and any additional regulations on a more local level. Take the time to research examples of similar LLCs and learn from what worked and didn't work for others in the past. If you don't know anyone whose brain you can pick to see what works or doesn't work for a similar LLC, talk to an attorney who specializes in them. Apply all of this knowledge to both the short- and long-term plans for your LLC.

Do Make an Effort to Stand Out

One of the worst things you can do to a new business is saddle it with unnecessary competition by being like everyone else. Success starts by choosing a name for your LLC. Choosing a name that blends in with similar businesses will make it even harder to become memorable and popular. A unique name can make or break a business, even if it sounds silly. We'll go deeper into the art of naming your business below.

Do Find a Registered Agent

Though not all states or countries require a registered agent to be appointed for your LLC, it's often a good idea regardless. Having a registered agent ensures that all the important documents related to your LLC are handled properly, saving you and your business a lot of possible headaches. We'll go into details shortly; for now, a registered agent is someone who acts on your behalf as the "face" of the company where legal documents are concerned. If your LLC doesn't have a physical office, you'll want a registered agent.

Do File Articles of Organization

Without this document, your LLC isn't an LLC, it's just a partnership that offers absolutely no protection. The requirements for your Articles of Organization will vary depending on where your LLC is located (See the section *Creating and Filing Your Articles of Organization* for more information).

Do Create A Comprehensive Operating Agreement

The flexibility inherent in an LLC can be a breeding ground for misunderstandings. A great operating agreement is essential for setting expectations, ensuring member compliance with the agreement, clarifying responsibilities, and keeping things running smoothly. This agreement provides the structure and guidelines for the LLC. It can also provide important insight into member responsibilities if it's a multi-member LLC. (See the section *Creating Your Operating Agreement* for more information).

Do Find Partners That You'll Actually Want to Work With

"Peopling" can be hard. Choosing the right partners for an LLC will make or break its success.

Potential partners could come to the table with very deep pockets, but also unrealistic expectations and goals that don't necessarily align 100% with yours. Or, potential partners could be more enthusiastic and all in than a Labrador Retriever with a tennis ball, but lack the skills to run a successful business.

There's no one-size-fits-all solution to creating a winning team. But you'll want to keep these tips in mind:

- Know your business goals, and do not partner with people who aren't on the same page and who don't share your values.
- Choose people with complementary skills and contributions.
- Consider the personality. Is this someone you want to work with? Every day? *All day?*
- Trust your instincts!

Don'ts

As I mentioned, plenty of people have done the heavy lifting for you, illustrating what *not* to do when forming an LLC.

Do Not Forget to Separate Business and Personal Finances

The reason the liability is limited for LLCs is because of the phenomenon known as "piercing the corporate veil." This occurs when you fail to keep your personal finances separate from your professional finances, making you and your business close enough in context for the courts to be able to come after your personal assets in the event of a lawsuit. Avoiding this possibility is usually as simple as creating a bank account specifically for your business and never using company money for any personal expenses.

Likewise, be careful when obtaining funding for your LLC. If your lender asks for a personal promissory note, your personal assets will not be protected if the LLC fails.

Do Not Avoid Compliance with Tax Requirements

Depending on where you live and what type of LLC you establish, there are tax rules and obligations that you can't let slide. Even if they feel irrelevant in the short term, they'll always catch up with you eventually if you fail to comply. Understand what your tax responsibilities are during your research stage and keep up with them. If you need help accomplishing this, hire a tax professional. The added cost will almost always be worth it in the end.

Do Not Rush

There is so much at stake when creating an LLC, the last thing you want to do is rush things. Rushing leads to mistakes that could be terribly costly down the line. Take the time to establish good partnerships, create a solid operating agreement, and fill out and file all legal paperwork that is free of mistakes.

CHAPTER TAKEAWAYS

- LLC stands for Limited Liability Company. This is a type of business structure that holds a lot of freedom and flexibility while also boasting limited personal liability protection.
- There are many types of LLCs, each developed for different situations. These types include: Single-Member LLC, Multi-Member LLC, Professional LLC, Series LLC, Family LLC, and Low-Profit LLC.
- The pros of an LLC center around flexibility and protection. LLCs can also be utilized to maximize investments, help plan your estate, protect your intellectual property, keep your assets separate, and perform short-term projects safely and cost-effectively.
- The cons of an LLC are mostly related to holes in their protection. However, these holes only occur when rules or laws are broken, or if you fail to keep your personal and professional affairs separate.
- LLCs are not the ideal situation for everyone. In certain states, professionals may need to form an LLP (professional limited liability company) instead.
- The alternatives to having an LLC are: Sole Proprietorship, S Corp, C Corp, and or a Limited Partnership. Depending on your situation, these may be more advantageous than an LLC.
- The decision to start an LLC or one of the alternatives for your business hinges on your business needs, goals, and preferences.
- The governing document of an LLC is the operating agreement, in which the owners (also known as members) agree on ownership percentages, membership interests, required contributions, tax allocations, distribution amounts, and the rulebook of the LLC itself.

- The dos and don'ts of forming an LLC illustrate common pitfalls that can cause headaches down the road.

In the next chapter, we will dive into how to form partnerships. We'll talk about the different ways you can structure an LLC to maximize the benefits to you and your business. You'll discover how to find the most fruitful partnerships, and create the rules for your LLC so that everyone's assets are protected, and you can start your business without any pitfalls.