Chapter 1

Starting an Event Business

Small opportunities are often the beginning of great enterprise. —Demosthenes

So, you have decided to make the leap from talented amateur to full-time professional events person. For years, everybody has said you throw the best parties, and now you want to do it for a living. Friends have promised that their companies will give you all of their events. You have events on the books before you have books. Where do you begin? How do you start a business?

First and foremost, you must decide on the form of the business. Realistically, the options have narrowed somewhat over the years. Whereas in the past, sole proprietorships and partnerships were somewhat popular, mostly due to the fact that there were no separate corporate and individual taxes, just individual, today they are fairly rare. The big reason for this is that both leave the owner(s) open to personal liability. This means that any debts of the business become debts of the owners personally, and any liabilities of the business can become personal liabilities.

■ CORPORATIONS

Most businesses are corporations. A corporation is a legal business entity established under the corporate laws of the state in which it is formed. It is formed for a particular business purpose and is governed by rules called *bylaws*. The corporation is a legal entity separate from the individual shareholders. It keeps its own books and records and finances separate from those of the individual shareholders. Its big advantage is that a shareholder's liability is limited to the amount invested in the business itself. A corporation is normally formed by filing Articles of Incorporation or a similarly titled document with the state. Therein, the corporation will have a fictitious name, and a document registering that name is also usually filed.

Thereafter, a form must be filed with the Internal Revenue Service to obtain an Employer Identification Number. This will be the number under which all tax filings and returns will be submitted to the IRS. Once the EIN is in hand, the business can open its bank accounts and begin its business activities.

➤ C Corporation

The C corporation is the most common form of business. A C corporation is one in which taxes are paid pursuant to Subchapter C of the Internal Revenue Code. As a taxpaying entity, the C corporation is required to pay federal taxes on its taxable income at the corporate level prior to making any distributions to shareholders. Many states also have a state tax on corporate income for which the corporation is responsible. Distributions to shareholders are taxed again.

C corporations are allowed to issue more than one type of stock (*common* and *preferred*) with different voting rights and dividend rights. There is no limit on the number of shareholders.

Certain legal formalities are required of the corporation, such as holding annual board meetings and annual shareholder meetings and keeping books and records according to state corporate law. Separate corporate bank accounts should be maintained. Likewise, federal and state tax returns must be filed.

As long as the required corporate steps are followed and corporate assets are kept separate and not commingled with personal assets (i.e., the corporation is not just a device or alter ego of the shareholders), corporate shareholders are protected by the *corporate veil*. The veil is a concept that separates the corporation as a legal entity from the individual shareholders. If the corporation is sued for any reason, the individual shareholders should be protected from any personal liability for the actions or omissions of the company. Liability is limited to each shareholder's capital investment in the corporation.

Because shareholders do not directly pay taxes on undistributed corporate profits, they do not need an additional dividend to cover the tax. Therefore, additional capital can be left in the business for expansion.

Susan has started an event planning business and has set it up as a C corporation. In her first year, the company loses $15,000. The loss stays in the company, and none of it is attributable to Susan's personal tax situation. The next year her company earns $25,000 in profit. She keeps it in the company to cover the cost of a bigger office space, and the company pays corporate tax on the profit. This has no impact on Susan's personal income.

➤ S Corporation

An S corporation requires the filing of a Subchapter S election with the IRS. By so filing, S corporations elect to be taxed under Subchapter S of the Internal Revenue Code. S corporations have limitations regarding number of shareholders and business purpose, but they are popular because all income passes through to the shareholders and there is no separate federal corporation tax. In the earliest stages of the business (and sometimes later on, although hopefully not) they have the additional advantage of allowing all losses to pass through to the shareholders. That may not hold true for state taxes, though.

Say Tom opens a party rental business, which he sets up as a Subchapter S corporation. In the first year of business, the company loses $75,000. Tom is able to apply the loss against any personal income he may have, thus lowering his personal tax liability (federal). In year 2, Tom's company makes $75,000, which Tom wants to leave in the business to purchase new tables and chairs. Under Subchapter S, he has to personally pay taxes on the $75,000, even if it is not distributed to him. This can be personally burdensome, and therefore the company can distribute the amount of the tax to him as a dividend to cover his tax liability.

Tom should now determine whether he wants to maintain the Subchapter S status. If his company is making money every year but needs to keep that profit in the company to grow the business, he will need to take a dividend every year to pay tax on the income attributed to him that he doesn't receive. He may want to speak with his accountant about dropping the S election and becoming a C corporation.

Just like a C corporation, an S corporation has a distinct legal identity, and all records must be kept separate and apart from those of the shareholders. All other corporate formalities must be followed to maintain the corporate shield from personal liability. Even if followed carefully, the possibility of personal liability exists if financial institutions require personal guarantees for financing. In such cases, any shareholders giving the guarantee are personally liable to the financial institution only.

➤ Limited Liability Company (LLC)

The most recent business form to gain approval under federal and state law is the limited liability company. It is a totally new form—not corporation, not sole proprietorship, not partnership. The owners are called *members,* not shareholders. It is now authorized in all 50 states and by the Internal Revenue Service. An LLC is created by filing a form with the appropriate department within state government.

LLCs are gaining popularity because they combine some of the best advantages of corporations and sole proprietorships and the benefits of a Subchapter S corporation, but without some of the restrictions. (See Table 1.1.) They offer the limited liability protection of a corporation, meaning the owners are not personally responsible for the debts and liabilities of the business. They are also pass-through tax entities, meaning that their income or losses pass through to the owners.

The philosophy behind the LLC is that the members should be free to *contract,* to agree among themselves, how the company is to be managed and to have that agreement stand up in court. This business form also offers substantially less red tape. Corporations require meetings of the board, meetings of the shareholders, corporate resolutions, corporate minutes, and other record keeping. LLCs have no such requirements. The operating agreement can contain any procedures and rules that the parties desire. The LLC offers simplicity of operation and very little ongoing maintenance.

At the same time, an LLC can have an unlimited number of owners, as opposed to the restrictions on a Subchapter S corporation. It can be owned by foreigners or by C corporations, other S corporations, many trusts, partnerships, or another LLC.

Decisions about the form of the business should be based on discussions with both an attorney and a certified public accountant. While many attorneys do have some tax knowledge, they do not always view matters from the same perspective as an accountant. Further, the accountant may have a better sense of personal financial considerations.

An individual starting a business will probably want the attorney to draft the necessary paperwork, just to make certain that all filings are taken care of according to law. Attorneys will often maintain the company books and records, making certain that all legal requirements are met year in and year out. Shareholder and board meeting minutes, corporate resolutions, and other important documents need to be created and regularly updated. Many companies can handle this on their own if they so choose. One way or the other, the records must be kept current.

Once the company form is determined, the accountant needs to be involved to set up the company's books and to set up the requisite accounts with the taxing authorities. Both the Internal Revenue Service and the state government require that filings be made, some quarterly and some annually.

Table 1.1 Comparison of Entities

Characteristics	Sole Proprietorship Partnership	Limited Liability Company	S Corporation	C Corporation
Formation	Agreement of parties involved	File with state for permission	File with state for permission	File with state for permission
Duration	Dissolved by death or bankruptcy	Typically limited to a fixed amount of time	Perpetual	Perpetual
Liability	Unlimited liability	No liability for members	Limited to capital invested in the corporation	Limited to capital invested in the corporation
Number of owners	1, 2 or more	1 or more	1 to 75	1 or more
Simplicity of operation	Few requirements	Relatively few formal requirements	Many formalities of record keeping and filing	Many formalities of record keeping and filing
Restrictions on ownership	None	None	Several	None
Management	Typically, each partner has equal voice	Members have operating agreement outlining management	Management by board of directors appointed by shareholders	Management by board of directors appointed by shareholders
Taxation	Each partner shares income or loss on his or her percentage ownership	Should be no tax at entity level—income or loss passed through to members	No tax at entity level—income and loss passed through to shareholders	Corporation is a taxable entity
Double taxation	No	No	No	Yes
Pass through income/loss	Yes	Yes	Yes	No

The outside professionals can train internal personnel to perform many of the necessary tasks, which will minimize the expense of legal and accounting hours. However, the professionals should be kept involved in the life of the company, reviewing its status periodically to make sure all is well. Further, over time, conditions change and the outside professionals can make recommendations to alter the structure based on those changes. A subchapter S election may be dropped, or a line of business may be organized into a separate entity.

So, while setting the company up is important, it is not necessarily final. It is important to remember that a company is a living, breathing entity, one that may change many times and in many ways over the course of its existence. Change can be good and healthy for the organization. Although many naturally resist change, it should be welcomed as progress.

■ SUMMARY

- Business forms vary, so careful thought should go into the choice.
- The key issues are legal liability and tax liability.
- Corporations (both S and C) and LLCs are the best combinations.
- You don't need a lawyer to file the papers, but legal and accounting advice in choosing a business form are important. Don't be penny-wise and pound-foolish. Doing it right from the beginning will save time and money.
- Once formed, the company needs to be maintained—books and records and yearly filings need to be kept up.