

Navigating the Minefield of starting your own business

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AMERICAN ACADEMY OF
NUTRITION AND DIETETICS

Agenda

- Introduction
- Entity Selection
- Definition of a Closely Held Business
- Is your side gig just a hobby?
- Multiple Business Owners?
- Employees?
- Liability Protection
- Recordkeeping
- Oh, the Horror!!!!

Introduction & Overview

Biography – Practice Areas

- Tax Planning
- Tax Litigation
- Estate Planning
- Probate
- Entity formation
- Business transactions
- Wealth preservation/Asset protection

Biography – Education

- LL.M. in Taxation, Georgetown University Law Center
- J.D. Cleveland-Marshall College of Law
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Biography – Bar Admissions

- Ohio
- District of Columbia
- Maryland

Biography – Organizations

- American Bar Association (ABA), Section of Taxation and Real Property/Trusts and Estates.
- Maryland Bar Association Section of Taxation.
- DC Bar Association, Section of Taxation.

Biography – Organizations

- Maryland Bar Tax Section Council
- Chair of the American Bar Association Tax Section Closely Held Businesses Sub-Committee.
- ABA Publications liaison - Tax Section Closely Held Businesses Committee.

Your Side Gig...



Entity Selection

- Sole Proprietorship
- Limited Liability Company
- General Partnership
- Limited Partnership
- S-Corporation
- C-Corporation

Entity Selection

- Limited Liability Company: A corporate structure whereby the members of the company cannot be held personally liable for the company debts or liabilities. Limited Liability Companies are a hybrid entity because it combines the characteristics of a corporation and a partnership or sole proprietorship. While the limited liability feature is similar to that of a corporation, the availability of flow-through entity taxation to the members of the LLC is a feature of partnerships.

Entity Selection

- Partnership: A type of business organization in which two or more individuals pool their money, skills and other resources, and share profit and loss in accordance with the terms of their partnership agreement. Both owners are equally and personally liable for the debts of the business. In the absence of such an agreement, a partnership is assumed to exist where the participants in an enterprise agree to share the associated risks and rewards proportionately.

Entity Selection

- S-Corporations: A form of a corporation that meets the IRS requirements to be taxed under Subchapter S of the Internal Revenue Code. This gives a corporation with 100 shareholders or less the benefit of incorporation while being taxed as a partnership. Maryland provides the option of taxation of profits either at the corporate or shareholder level (tax on certain capital gains and passive income).

Entity Selection

- C-Corporation: A legal entity that is separate and distinct from its owners. Corporations enjoy most of the rights and responsibilities that an individual possesses (right to enter contracts, loan and borrow money, sue and be sued, hire employees, own assets and pay taxes). The most important aspect of a corporation is limited liability. Shareholders have a right to participate in the profits, through dividends and/or the appreciation of stock, but are not held personally liable for the company's debts.

Top 10 Factors in Choosing a Business Entity

- PRODUCT LIABILITY?
- ENTITY NEEDS?
- MERGER OR ACQUISITION?
- EMPLOYEE COMPENSATION?
- PAYMENT OF SALARY?
- CONTRIBUTIONS TO THE BUSINESS?
- BUSINESS GENERATING LOSSES?
- SPECIAL ALLOCATIONS OF INCOME?
- NEED FLEXIBLE BUSINESS PLAN?
- SAVE \$\$\$\$\$?

Closely Held Business

- Entity owned by an individual or small group of owners who are often members of the same family.
- Not a Personal Service Corporation (employee-owners substantially perform the services – more than 20% of compensation cost for performing personal services is that of its employee-owners); Employee-owners own more than 10% of the FMV of its outstanding stock.
- PSCS include law firms, accountants, architects, consultants, engineers, health Including veterinarians, performing artists, actuarial science.

Closely Held Business

- Gross Revenues are irrelevant.
- Each owner owes each other a fiduciary duty – implied covenant of good faith and fair dealing. One cannot knowingly take actions that would harm other owners.
- Advantages/Disadvantages.

Is your side gig just a hobby?

- IRC § 183.
- Treasury Regulation § 1.183-1.
- Treasury Regulation § 1.183-2.

Is your side gig just a hobby?

- IRS Tax Tip 2022-57, April 13, 2022. A hobby is any activity that a person pursues because they enjoy it and with no intention of making a profit. People operate a business with the intention of making a profit.
- IRC § 183(c): “Activity not engaged in for profit” means any activity other than one with respect to which deductions are allowable for the taxable year under IRC § 162 or under paragraph (1) or (2) of IRC § 212.
- IRC § 183(d) Presumption that the activity is "for profit" – “3 out of 5-Year Rule.”

Is your side gig just a hobby?

For Profit Factors

- The way the taxpayer carried on the activity.
- The expertise of the taxpayer or his or her advisers.
- The time and effort expended by the taxpayer in carrying on the activity.
- The expectation that the assets used in the activity may appreciate in value.
- The success of the taxpayer in carrying on other similar or dissimilar activities.
- The taxpayer's history of income or loss with respect to the activity.
- The amount of occasional profits, if any, which are earned.
- The financial status of the taxpayer.
- Elements of personal pleasure or recreation.

Multiple Business Owners

- How well do you know your “business partner?”
- Management.
- Capital Accounts.
- Profit/Loss Allocations.
- Misbehavior of co-business owner.
- Buy/Sell Agreement.

You want to hire employees?



Employee Classification

- Statutory Employees (IRC § 3121)
- The IRS Control Test (Common Law).
 - 20-point test in Revenue Ruling 87-41 has evolved into three categories.
 - Behavioral control.
 - Financial control.
 - Relationship of the Parties.

Employee Classification

- Treas. Reg. § 31.3121(d)-1(c) - Common law employees.
- FICA (Federal Insurance Contributions Act).
- FITW (Federal Income Tax Withholding).
- FUTA (Federal Unemployment Tax Act).
- State.

Employee Classification

- Unemployment Insurance (Md. Code Ann., Lab. & Empl. § 8-205).
 - Applicable Test (ABC Test). Work is not considered employment if:
 - The individual who performs the work is free from control and direction over its performance both in fact and under the contract;
 - The individual customarily is engaged in an independent business or occupation of the same nature as that involved in the work; and
 - The work is: (i) outside of the usual course of business of the person for whom the work is performed; or (ii) performed outside of any place of business of the person for whom the work is performed.

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- Worker's Compensation (Md. Code Ann., Lab. & Empl. § 9-202). (Right to Control).

Liability Protection

- Internal Corporate Documents.
- Business Operations.
- Business/Commercial Liability Insurance.
- Bookkeeper.
- CPA.

Recordkeeping – Why keep good records?

- Income Statement (Income/Expenses).
- Balance Sheet (Assets/Liabilities/Equity).
- Identifying sources of your income.
- Keeping track of your deductible expenses
- Keeping track of your basis in property
- Preparation of Tax Return (Supporting documents).

Recordkeeping – Why keep good records?

- Dealing with your bank.
- Dealing with your creditors.
- Prevent fraud or theft.
- Compliance.

Recordkeeping – Why keep good records?

- Manage Cash Flow.
- Save Time/Costs.
- Making Business Decisions.
- Place/Time/Purpose of expenses.
- No Spreadsheets!

Business Owner Misbehavior (Franchise Context)

- Medical Practice Franchises are in vogue.
- Franchisee needs a doctor/dentist as the “face” of the entity, usually set up as a PC or LLC.
- Unsuspecting doctor/dentist signs documents without advice of counsel and many times without reading them.
- Franchisee executes a Management Agreement with the unsuspecting doctor/dentist.

Business Owner Misbehavior (Franchise Context)

- Doctor/Dentist gets paid for performing medical/dental services but otherwise is not involved with entity operations/management.
- Franchisee does not file return and/or does not pay required employment tax/withholdings.
- Doctor/Dentist receives surprise correspondence from IRS or State/Local Tax Authority.
- Doctor/Dentist may be deemed to be a responsible person.

Business Owner Misbehavior (Mixing Personal with Business)

- Possible deemed “dividend.”
- Breach of contract.
- Possible violation of statute/regulation.
- Losing legitimate tax deductions.
- Recordkeeping issues.
- Breach of Fiduciary Duty.
- Withdrawing corporate funds to pay your bills.
- Exposure to risk.

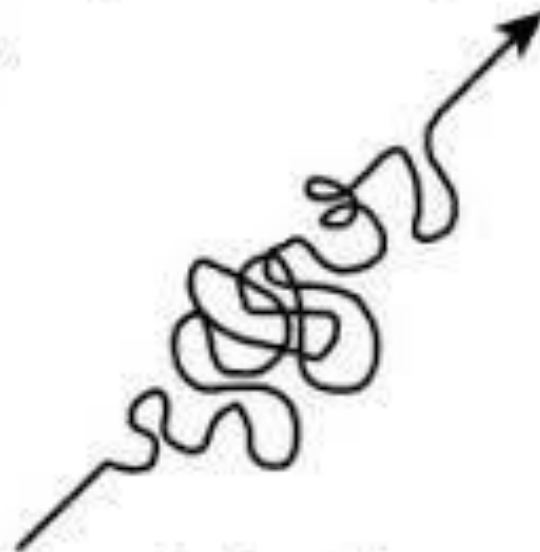
SUCCESS!

SUCCESS

SUCCESS



what people think
it looks like



what it really
looks like

Q & A



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