

GETTING STARTED **LLC BASICS**

Setting up Shop Legally & Financially

SCORE
FOR THE LIFE OF YOUR BUSINESS

STEP 1: FORMING AN LLC (IN MAINE)

Start by picking two or three names of interest (Google around for ideas!) and seeking feedback from your SCORE Mentor or other trusted colleagues. Once a name is selected, the State asks that you make a 'good faith' effort to establish that the name is unique. One tool to assist in that search is **whitepages.com**. Additionally, the **Maine State database of registered corporate entities** is also searchable.

Once the search is completed, the next step is to **register the name with the Secretary of State**. Scroll down the left-hand margin and click on **Limited Liability Companies**, and from there, scroll down and click on **MLLC-6, Certificate of Formation**. There is a $175 initial filing fee. It is necessary to fill out the Certificate of Formation and mail it, along with the $175 filing fee, to the Secretary of State in Augusta. It is important to include the third page on which the applicant shows its email address; the Secretary of State will send an email annually to remind the owner to file its Annual Report, which can be done online, including paying the annual filing fee.

Questions often arise regarding the **Registered Agent**. The state in which your business is registered needs to know that it has a contact person for your business within the state at all times. If you are a Maine-based business and Maine is your permanent residence, you can list yourself as a Noncommercial Registered Agent; otherwise, you will typically list your attorney or CPA firm as a Commercial Registered Agent after first informing the firm that you intend to do so and obtaining their CRA Public Number. Just remember, you have to list a physical address (street name and number), not a post office box.

STEP 2: ESTABLISHING AN LLC OPERATING AGREEMENT

WHEN DO YOU NEED AN OPERATING AGREEMENT?

An Operating Agreement is a contract document which sets up guidelines and rules for the internal operations of an LLC. Maine law requires each LLC to have an Operating Agreement. It will never be requested unless and until the LLC is sued for some reason. If there isn't an Operating Agreement in place, the opposing attorney will challenge the legitimacy of the LLC, so the client should complete the Operating Agreement, date and sign it, and put it in the file so it exists - if and when it is ever required.

HOW DO YOU DRAFT AN OPERATING AGREEMENT?

If there is only one owner, SCORE's **Single Owner Operating Agreement** is an easy template to use for a simple operating agreement. If there is more than one owner, an Operating Agreement is

even more critical because it defines important governance aspects, such as the board of directors, liquidation, buying and selling between owners, etc. Most new business owners do not contemplate disagreements or even divorce, but they should have an Operating Agreement that addresses both.

Multi-owners are encouraged to use SCORE'S **Multi-Owner Operating Agreement** not as a template, but as a guide to the issues upon which they need to reach agreement. By using this guide, making decisions on key issues and writing them down time spent with an attorney to prepare the real Operating Agreement can be reduced, along with the expense.

STEP 3: GETTING AN EMPLOYER IDENTIFICATION NUMBER (EIN)

WHY DO I NEED AN EIN?

An employer identification number, or EIN, is a nine-digit number similar to a Social Security number. It is assigned to a business entity by the IRS, and business entities required to file tax returns use an EIN in the same way that an individual uses a Social Security number. The IRS uses the EIN like an account number to keep track of tax returns. An EIN is also needed to open a business financial institution account for an LLC.

HOW DO I GET AN EIN?

Once you have a State of Maine registered name, you'll need to **apply online for an EIN from the IRS**. If your business is a single-member LLC, the company will be treated as a "disregarded entity" by the IRS and no tax return will need to be filed by the company. Instead, the owner will report company revenues and expenses (and net profit) on the Schedule C to his or her annual 1040 tax return.

STEP 4: OPENING A BANK ACCOUNT

First and foremost, choose the best financial institution for your needs. It is much easier to work with an institution that has a local branch, and SCORE recommends you select one where you have (or will have) a personal account. If you contemplate needing loans, you might research a good financial institution for this and set up an account there, though that is not required. We also recommend selecting a financial institution that has online banking and is compatible with QuickBooks.

Visit the financial institution in person to request an account, bringing your LLC formation documents and EIN, plus an initial deposit.

Critical features that you will want with your new account are: 1. Electronic link to your personal bank account for transferring funds (back and forth), 2. A debit card in the name of the LLC, and online bill payment. Online banking, debit cards, etc. are essential tools to bookkeeping for your LLC with minimal labor.

Once you establish your LLC account, IT IS VITAL THAT YOU SEGREGATE PERSONAL AND LLC FUNDS AND EXPENSES. If you do not, this may result in a determination that your limited liability company is not valid and expose your personal assets to the liabilities of the business.

STEP 5: CHOOSING (AND USING) ACCOUNTING SOFTWARE

QuickBooks is highly recommended due to low cost, simplicity, ease of use and compatibility with most financial institutions, which allows online syncing. SCORE regularly offers low-cost Quickbooks training through our **local workshops**.

To minimize owner work on accounting software, use online bill pay for as many transactions as possible. In QuickBooks, you train your profit and loss statements to recognize your vendors and categorize payments to them. Once you have categorized all your vendors, QuickBooks will generate profit and loss statements at your command for any periods of time. Until your business gets large, you should only need an accountant for taxes and unusual issues that may arise (e.g., depreciation).

STEP 6: HIRING A PAYROLL COMPANY

Payroll management is complex and difficult for the inexperienced. Fortunately, there are many payroll management companies for any size business, and their prices are quite affordable. QuickBooks has a very inexpensive payroll system, as does **Gusto**, **Sage** and **Square**. Costs are typically less than $50/month for small businesses. Take care when selecting a payroll management company, assuring that it has not only an established history, but a reputation for reliability. It is important to be cautious because the failure of a payroll management company to remit withholding and payroll taxes does NOT relieve the business owner from that obligation. You could get charged twice!

STEP 7: PAYING YOURSELF

The beauty of an LLC is that it provides owners with limited liability (like a traditional C Corporation) but is a single tax entity, like a sole proprietorship or partnership. Accordingly, the characterization of payments to owners is less important. Owners are taxed on their individual returns in the amount of their pro rata (proportional) share of the LLC's profits or losses, regardless of whether there were distributions. If the LLC has multiple owners it will have to file an annual income tax return and provide to each owner the appropriate statement of his or her share of the net income, with a copy provided to the IRS. Currently, this form is called the "K-1".

Mechanically, it's best to link the LLC account with the owners' account and transfer funds electronically. This is usually called an owners' draw, and is up to the owners how much it will be.

Loans and loan repayments can also be used, but generally are only important with multi-owners where one loans more than the others to the LLC.

SHOULD OWNERS PAY THEMSELVES A SALARY OR OWNERS' DRAW?

For single owner entities, it doesn't matter. In the past, it mattered due to payroll taxes, but now, self-employment taxes are exactly equal to payroll taxes (15.3%). If there are multiple owners, however, this could be an important issue. Often, one owner works much more for the LLC than others. In that case, a market-based salary is often agreed to by the LLC to avoid enriching the passive owners.

After the first year of operation the owners may need to make quarterly estimated payments of income tax to the IRS, so the owners will want to make appropriate distributions to themselves to fund such tax payments.

STEP 8: FINDING FUNDING

In the beginning, securing funds from any source other than the owner's own resources, family, or loans guaranteed by the owners can be challenging for an LLC. Financial institutions are very unlikely to loan to a new business without collateral and personal guarantees.

There are some external sources for loans, like the **Finance Authority of Maine (FAME)**, **Coastal Enterprises (CEI)**, and **Maine Technology Institute (MTI)**, but these are usually subsidized or partially guaranteed loans.

Sources like crowd funding are possible, but the business would generally have to be very attractive publicly to bring in funds (e.g., very cool product, unusual concept, social purpose).