



Writer, Inc.

by Kathryn Page Camp

Writers often wonder if they should incorporate. After all, writing is their business, and many businesses are corporations. So what is the best business form for a writer? It depends on what matters to you.

The three main types of business entities that work for individual writers are sole proprietorship, corporation, and limited liability company. Writers that partner with others (e.g., as co-authors) have additional choices, but those legal forms are beyond the scope of this article.

Most of the laws relating to business organizations are state laws. The information in this article is general enough to be true in most, if not all, states, but you should check the law of your own state for more details.

Sole Proprietorships

A sole proprietor is an individual who conducts his or her business without creating any special legal form. Although the writer can use an alias or a pseudonym for business purposes, legally the sole proprietor and the individual are one and the same person.

The main advantages of a sole proprietorship are that it is easy to set up and operate (you don't have to do anything except keep good business records), and it has the fewest legal requirements. Yet a sole proprietor can still do most of the things other businesses can, including hiring employees. The owner-writer is not an employee, however.

The main disadvantage to being a sole proprietor is that you have no personal protection from liability for your writing activities. As discussed later, this doesn't make as much difference for writers as it does for some other businesses.

Taxes are another consideration, but they don't fall in either the advantage or disadvantage category. A sole proprietor files Schedule C with his or her personal income tax return rather than filing separate business taxes. If your writing is a business (see separate article called "Tell it to the IRS"), you can deduct your business expenses from other income, including your spouse's salary (if you file jointly) and any money you make from an unrelated job. You will

have to pay self-employment taxes if you make a profit of more than \$400 from writing, but the federal government would take the same amount even if you incorporated.

You may also have to pay sales taxes. If you sell your books out of the back of your car or at events where you are responsible for collecting your own sales taxes, you will need a business license in the state where you are making the sales. This is true regardless of the business form you choose to use.

Corporations

A corporation is a separate legal entity owned by its shareholders and run by its officers and directors. A corporation may have a single owner who is also the only officer/director, as is usually the case with writers who incorporate. If you incorporate your writing business, you become an employee of the corporation. The corporation receives your royalties and fees and pays you a salary.

The main advantage of incorporating any business is that it limits your personal liability for the corporation's activities. As mentioned above and discussed in more detail below, this isn't as big an advantage for writers as it is for some other types of business activities.

There are also disadvantages to incorporating. For one thing, you must invest money in the corporation. Although there is no hard and fast rule about how much this investment must be, a good rule of thumb is to have enough money in the corporation's name to cover the corporation's operating expenses (which include your salary) for the period it would normally take to start making a profit. If you fail to keep enough money in the corporation, you may be personally liable for the corporation's business expenses.

Even when you are the only owner, the money you invest in the corporation belongs to the corporation, not to you personally. This doesn't mean that you can never take money out, but you can't treat the corporation's money as if it were your own. You have the right to a reasonable salary and reasonable bonuses, but you must handle them the same way other businesses do. For example, you can't take a "salary" that changes every month depending on income and you can't pay yourself bonuses without a reasonable basis. You also have to put in regular work (writing, marketing, and so on) to earn your salary.

You can take additional money out of the corporation as dividends (money you receive as an owner rather than as an employee) as long as you keep enough money in the corporation to cover its debts for a reasonable period of time. However, this money is taxed twice—once as profits to the corporation and once as income to you. Neither the restrictions on taking money out nor the double taxation apply to sole proprietorships.

The many legal formalities of forming and maintaining a corporation are also a disadvantage. These requirements include preparing and keeping documents that you wouldn't need as a sole proprietor (such as articles of incorporation, bylaws, and minutes) and other ongoing responsibilities. Don't be lulled by advertisements that tell you how easy it is to incorporate. I also don't recommend relying on do-it-yourself software or kits. They are better than nothing,

but they cannot understand your needs the way a lawyer can. Also, some programs are not updated quickly when the law changes. Since state law governs the process, you need someone who understands the law in your state.

Forming a corporation may lower your taxes—or it may raise them. You pay personal income taxes on the money you receive from the corporation, and the corporation pays taxes on the profits it makes after deducting its expenses (which include your salary). Whether or not you come out ahead tax-wise depends on several factors, including how much profit or loss the corporation makes and the amount of income that is reportable on your personal tax forms. You cannot deduct your business expenses when calculating your personal income taxes, so if your writing business loses money, you will pay more taxes than you would as a sole proprietor. If your writing business makes a profit, you may benefit if the corporation's tax rate is lower than your own.

Corporate tax forms can be more complicated than the Schedule C you file with your personal taxes as a sole proprietor. And if the IRS decides that your salary and bonuses are a sham (because they don't follow normal business practices, for example), it may treat them as dividends, subjecting them to the double tax.

Limited Liability Companies (LLCs)

A limited liability company (LLC) has the same protection against personal liability as a corporation but the same tax treatment as a sole proprietorship. Using an LLC can also help you avoid some, but not all, of the formalities a corporation requires. As with a corporation, an LLC also requires an initial investment. If you are considering incorporating, an LLC may be a better option. State law governs the legal requirements for forming and operating LLCs, so consult an attorney in your state.

The problem with incorporating to limit liability

The main reason people incorporate small businesses is because being a corporation (or an LLC) limits the liability of its owners. Someone who sues and wins a judgment can take everything the corporation owns, including the money the owners have invested in it, but the person who sued cannot usually reach into the owners' pockets. Unfortunately, this isn't as big an advantage for writers as it is for most businesses. Here's why.

For our purposes, there are two main types of liability:

- 1) liability for negligent or wrongful acts, and
- 2) liability for business debts.

Liability for Negligent or Wrongful Acts. Assume your corporation owns a garage that employs several mechanics to repair cars. A customer brings his car in to get the brakes fixed, and one of the mechanics fails to notice and replace a faulty brake pad. As the customer is driving home, he gets into an accident because he couldn't stop the car on time. He can sue the garage and the

mechanic, but he can't win a lawsuit against you unless you did the work or should have known it wasn't getting done right.

Now think about what you do as a writer. You are most likely to get sued for libel or copyright violations, which are the subject of separate articles. As a writer, you are not just the owner of the corporation, but you are the mechanic as well. Since you wrote the words that could be libelous or violate someone's copyright, you can get sued personally, and the fact that your writing business is a corporation won't help you there.

Liability for Business Debts. Now assume your corporation runs a health club. It took out a \$200,000 loan to cover start-up costs, which include franchise fees, rent, and exercise equipment. Unfortunately, you chose a location that is already saturated with health clubs, and you can't attract enough members to make the loan payments. Even worse, the members you do attract are hard on the equipment, so it loses its value quickly. The corporation has no choice but to file for bankruptcy. Since it is a corporation, however, your personal assets are safe (assuming you did not co-sign on the loan).

Now think about the expenses you incur as a writer: paper, ink cartridges, professional magazines and association dues, writer's conferences, a new laptop every few years, and other modest costs. And although you may pay for some with your credit card, you probably don't carry a big tab. So you may not need to incorporate to protect yourself against liability for your business debts.

But there are exceptions. If you have employees, incorporating can protect you from at least some of their mistakes. Or maybe you have unusually high business expenses for self-publishing, marketing, or research. Either of these may be a reason to incorporate or form an LLC. It all depends on your particular circumstances.

For more information

You can find more information on the different types of business entities at <http://smallbusiness.findlaw.com/starting-business/>. To find an attorney, call your local bar association for a referral to a lawyer who does corporate law.