Should you use an LLC or an S-Corporation When Opening a Fitness Studio or Gym?

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One of the first questions new clients ask me when forming a new fitness studio or gym is whether or not they should be an LLC or an S-Corporation. These two types of entities are selected by more than 95% of my clients because each is tax favorable to the business owner. Both types of entities have flow through taxation, which means the entity level does not pay tax – but instead the earnings of the business flow through to the member’s/shareholder’s personal tax return where taxes are ultimately paid.

In general, the clear trend in the legal industry is to form as an LLC due to its flexibility, especially if there will be multiple owners or outside investors. S-Corporations require more paperwork and require a more rigid management structure. Specifically, S-Corporations must hold organizational and annual meetings to elect directors and officers. In addition, there are restrictions on who can be a shareholder in an S-Corporation. Some business owners choose to go the S-Corporation route to save on self-employment taxes, but often times those savings will be offset by other annual corporate maintenance and accounting/legal costs.

Conversely, an LLC allows a business owner to retain a great deal of control over the LLC, even if there are other members of the LLC (members are the equivalent to “shareholders” of an S-Corporation). While an LLC may have several members who contributed capital to the LLC, if an LLC is “manager-managed” (you choose member-managed or manager-managed when forming the LLC), the manager will retain control over the direction and the key decision making of the business. In this way, the manager of an LLC acts in a similar role to the entire Board of Directors of an S-Corporation.

An added benefit of using an LLC is the ability to share profits in creative ways. In an S-Corporation, profits must be distributed out to shareholders equally based upon the number of shares that he or she owns in the S-Corporation. In an LLC, a preferred distribution can be made to certain members based on the terms of the business deal between the members. In the context of opening a studio, certain equity contributions by members may be entitled to a preferred dividend for a fixed period of time in return for the risk of investing in the studio; after the agreed to preferred distribution has been paid out, all future distributions of the business may then be split equally by all members in based upon their equity ownership interest in the LLC.

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