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FREQUENTLY ASKED QUESTIONS

What is a Limited Liability Company (LLC)?

A limited liability company (LLC) is a type of legal entity under which a business may choose to operate. Forming an LLC protects the LLC's owners (known as "members") from personal liability. This protection is called "limited liability," meaning that if someone were to sue the LLC and/or its members, the personal assets of the members (such as their car, bank account, home, etc.) could not be touched, only the assets of the LLC. Some business entities, like sole proprietorships, general partnerships or unincorporated associations, do not have limited liability protection, and the owners' assets could be at stake in a lawsuit.

Why might we form a corporation for our worker cooperative instead of an LLC?

Some cooperatives with immigrant members choose to form a corporation instead of an LLC. Cooperatives that choose this often do so because they function as marketing or referral cooperatives instead of worker cooperatives.

In a marketing/referral cooperative, the cooperative's main function is to serve as a central place for marketing the services of its members and to refer jobs to members. Members market their services under the name of the cooperative, the cooperative makes the referral to the member for the job, and then the member contracts individually with a client. Members perform services on their own and are paid by clients directly; they basically run their own individual businesses. They are not employees of the cooperative or independent contractors working for the cooperative, but rather independent business owners coming together to form a cooperative in order to market their services and share referrals.

As members of the cooperative, they pay a membership due in return for the cooperative's marketing and referral services, and they participate in making decisions about the cooperative's marketing and referral activities. The cooperative does not bill clients or pay its members for work. A cooperative that functions like this might choose to be a cooperative corporation in states that have cooperative corporation laws. If you would like to learn more about this model, please contact a cooperative attorney.

WORKER COOPERATIVES & LLC'S HANDOUT

In a worker cooperative where the cooperative itself contracts with clients, and the members work under the cooperative, choosing a corporation requires the cooperative to treat worker-owners as employees for tax purposes.

How are taxes dealt with in an LLC worker cooperative? What are some precautions?

Businesses pay a variety of state and federal taxes. These include state and federal income tax, employment taxes, sales taxes, etc. For purposes of this discussion, we focus on federal income and employment taxes. To pay federal income taxes, the LLC files Form 1065 with the IRS. This document gives the IRS information about the LLC's income, losses, deductions, and credits, among other items. It also includes information about the portion of profits and/or losses that went to each member. This is reported on Schedule K-1, which each member also files with their personal taxes.

In addition to federal income tax, the LLC will most likely also be responsible for taxes at the state level. This varies state by state. For example, in California, corporations and LLCs are subject to a minimum CA franchise tax of \$800.

Self-Employment tax

Worker-owners in LLCs are considered to be self-employed, and are therefore responsible for paying self-employment tax, in addition to income tax, on the money they make through the cooperative (though they can deduct half of the self-employment taxes they pay before calculating income tax).

Because the IRS does not tax the business, any net profits that the coop might want to keep in the business for future coop expenses will have to get divvied up among members at the end of the year, with members paying self-employment and income taxes on that amount. Some cooperatives distribute additional amounts to members to cover the cost of the member paying taxes on money that will remain in the business for coop purposes.

Note also that members will need to make quarterly estimated tax payments if they expect to owe more than \$1,000 of tax for the year.

Taxes are highly specific to the business and to each individual, thus the coop and the individual members should all consult a trusted accountant who knows the LLC structure.

Can member capital accounts be set up in LLC worker cooperatives? If so, what are some general guidelines?

An LLC Cooperative should set up a Capital Account for each of the members, which reflects members' individual ownership of the cooperative's assets. Taken collectively, the members' accounts add up to the net worth of the cooperative.

The value of each member's Capital Account is equal to the sum of any initial payment the member might have made to join the cooperative, any additional investments a member makes after joining, plus the member's share of income or profits allocated to the member's account, minus the share of

expenses or losses allocated to the member's Capital Account and funds distributed to (taken out by) the member.

What is the role of the cooperative developer when working with a member-managed LLC?

Cooperative developers' roles vary depending on their approach and relationship with the cooperatives they assist. Some developers have a "high touch" approach which could entail recruiting the founding members, developing a business plan and operational manual, and providing intensive member training. Some high touch developers employ and supervise an office and/or general manager(s) of the cooperative. Sometimes these office managers and general managers employed by the nonprofit also serve on the LLC's Board as advisors or as actual Board members with limited voting rights. In contrast, "low touch" developers may assist cooperatives with a referral to a coop attorney and accountant that is familiar with the LLC structure, and may also consult on the creation of the business plan. An emerging approach in the field is one in which coop developers are also anchor clients of the LLC coop, for the purpose of getting the business started more quickly than usual, in other words, a "rapid response" cooperative.

ABOUT US

Founded in 2006, **Immigrants Rising** transforms individuals and fuels broader changes. With resources and support, undocumented young people are able to get an education, pursue careers, and build a brighter future for themselves and their community. Immigrants Rising is a fiscally-sponsored project of Community Initiatives. For more information, visit www.immigrantsrising.org. For inquiries regarding this resource, please contact Iliana Perez, Director of Research & Entrepreneurship, at iliana@immigrantsrising.org.