

DON'T BE CAUGHT OFF GUARD BY THE TAX AND LEGAL CONSEQUENCES OF YOUR NEW QUARANTINE HOBBY (PART 1 OF 3)

The coronavirus pandemic has forced most of us to stay home, and as a result, we are all looking for hobbies to pick up while we are social distancing. For some, quarantine hobbies have become Netflix binge watching or mastering bread baking. For others, creative passions and hobbies such as selling handmade crafts on Etsy or unwanted junk on eBay have become sources of income. If you are dabbling in a quarantine hobby that produces income, here are some tips for choosing between legal structures in order to better protect yourself and your business.

Whether you have just started selling your handmade crafts online, or you are a veteran in the trade, one of the most important legal questions for online sellers to determine is: **What is the best legal structure for my business?** This article will help you decide on the best way to structure your newly founded business.

Please check back in the next two weeks for our other articles, which will address tax issues relating to your online business, and good business practices for operating and running an online business.

Remember, your online business is a *business* whether you like it or not, so please think about the appropriate business structure

Your online business is your business, and it is important that you set up your business as a legal business entity. There are a number of legal business structures to choose from. Which business structure you choose will impact the taxes you pay, the paperwork you are required to file in order to establish your business, and whether you can be held personally liable if someone sues your business. The most common legal structures are as follows and will be described in detail below:

- Sole proprietorship
- Limited liability company
- Corporation

Easy as 1, 2, 3: Sole Proprietorships

A sole proprietorship is an unincorporated entity, which is the easiest and cheapest way to operate your business; however, it comes with more risks than a limited liability company or corporation. With a sole proprietorship, you don't need to file any legal forms with the state you are operating in or pay any fees to the state to establish your sole proprietorship. If you have already sold one handmade craft, you're technically operating a sole proprietorship and no legal paperwork is needed to be filed. That was easy, right?

If you are operating as a sole proprietorship but would prefer to operate under a different name other than your own, you may need to file a certificate with your state for a "DBA" or "doing business as" name. For example, if your name is Bob Smith then technically your sole proprietorship is also named Bob Smith. However, if Bob sells handmade fishing poles on his online shop, he can choose to do business as "Bob's Fantastic Fishing Poles" or any other name he chooses to do business as.

Further, depending on what you're selling and where you're selling from, you may also need to obtain certain business licenses (e.g., a seller's permit). Therefore, before you start selling, it's important to look up and comply with local and state laws to avoid violations and fines.

One of the major drawbacks with operating a business as a sole proprietorship is the fact that you may face personal liability if someone is harmed or injured by your handmade crafts and you end up being sued. Not only are you risking your online business's livelihood, you could also be risking your home, your car, the money in your bank account, and more. All those things might not be worth risking for a few hundred dollars in your pocket, right? If you are selling handmade crafts that come with even a slight risk of being injurious, toxic, or harmful to individuals, we highly recommend that you consider incorporating or organizing your business through a corporation or limited liability company, which is described in more detail below.

Uncharted Waters: Limited Liability Companies and Corporations

Whether you have quit your day job to make custom wooden tables or are merely crafting and selling earrings out of your basement as a hobby, it is still a good idea to form a limited liability company or corporation to protect yourself from personal liability (as described above).

Although forming a limited liability company or incorporating your business will be more expensive and time consuming than starting a sole proprietorship, the time and money will likely be worth it. In order to form a limited liability company or corporation you will need to pay fees and file paperwork with the Secretary of State (or similar office) in the state in which you intend to organize your limited liability company or incorporate your business. Depending on your needs and wants, it may make sense to research certain state laws to determine whether your home state or another state is best for formation of your new business.

A limited liability company and a corporation will both limit your personal liability to how much you put into the company. This means that if someone is to get injured from one of your business's handmade crafts, theoretically (if all corporate and limited liability procedures are followed) the most you could end up losing is the assets, including cash, that you have in the company. While this may not be an ideal situation, it is much better than losing your personal assets over a \$10 set of earrings that harms an individual.

Lastly, the process of incorporation typically requires more time and money than other legal entities. Not only does a corporation require a board of directors and more formal requirements than that of a limited liability company (like holding regular board meetings and recording minutes), a corporation is taxed differently than a limited liability company, which could be a deciding factor on how you structure your newly founded online business.

The thought of incorporating or organizing a business entity may seem a bit daunting at first, but our team at O'Neil Cannon is prepared and ready to help you. Please speak to your regular OCHDL contact, or the authors of this article, attorney [Britany E. Morrison](#), to get your business up and running.