From Side Gig to LLC

Idea In Short

Form a limited liability company [LLC] when your freelance work carries real liability risk, such as client contracts with indemnity clauses, advice, client data or plans to hire. File in the state where you live and work, get a free Employer Identification Number [EIN] from the Internal Revenue Service [IRS], open a dedicated business bank account and write an operating agreement. Expect no tax change at first, because a single-member LLC still reports income on Schedule C and pays self-employment tax. Budget for annual state costs, such as California's $800 tax, and calendar every deadline. Keep personal and business money apart, and buy errors and omissions insurance, because the LLC does not cover your own professional mistakes.

Most freelance careers start without any paperwork at all, which is part of the appeal. You land a client, send an invoice, and suddenly you are running a business, whether you planned to or not.

If you have not registered anything, the law treats you as a sole proprietor by default. That setup is simple, but it offers no separation between you and your work, so a client dispute or unpaid business debt can reach your personal savings, car or home.1

Forming a limited liability company [LLC] is the most common way freelancers draw that line. It is also more affordable than many people assume, since services built around cheap company formation can prepare and file the paperwork while you pay little more than the state fee. Here is how the process works and what changes once you make the switch. The sections below cover the signs that justify the move, the limits of the protection, the filing steps, the tax effects and the costs that continue each year.

Signs your side gig is ready for an LLC

No income threshold forces you to form an LLC, and plenty of freelancers work as sole

proprietors for years. Still, a few situations make the move worth a serious look:

- Larger clients ask you to sign contracts with indemnity or liability clauses
- Your work carries a real risk of claims, such as giving advice, handling client data or building products
- Your income is steady enough that you want a clear line between personal and business money
- You plan to hire help or bring in a partner

If none of these apply yet, staying a sole proprietor is a legitimate choice. The decision comes down to risk and structure far more than appearances. A contract with an indemnity clause, for example, can make you answerable for a client's losses, which turns a routine engagement into a personal exposure. Work that involves advice, client data or products raises the chance that a client eventually claims a loss. Steady income and plans to hire push in the same direction, because more money and more people tied to your name give a dispute more to reach. Weigh these signs against the cost of forming and maintaining the company, which the later sections itemize.

What an LLC protects and where it stops

An LLC is a separate legal entity, so debts and lawsuits against the business generally stay with the business. That shield has limits, though, and it helps to know them. Freelancers typically encounter those limits in two areas: their own professional work and their financial management. The two subsections below take each in turn. Understanding both limitations before you file prevents you from treating the LLC as an unconditional guarantee.

Your own mistakes still follow you

An LLC usually will not protect you from liability for your own negligence or professional errors. If a consultant, designer or developer causes a client loss through their own work, the claim can still reach them personally. Professional liability insurance, often called errors and omissions coverage, fills that gap. The company shields you from the business's contracts and debts, such as a lease or a vendor bill, but it does not turn your personal work product into someone else's responsibility. Compare insurance premiums against the value of the contracts you sign, and confirm whether clients require a minimum level of coverage.

Mixing money can undo the shield

Courts can disregard an LLC, a step known as piercing the corporate veil, when the owner treats business and personal funds as one pot. Paying for groceries from the business account or depositing client payments into a personal one weakens the separation. Courts weigh factors such as significant undercapitalization and the intermingling of company and owner assets, and no single factor is always required.2 A dedicated business bank account is the simplest safeguard. Pay business expenses from the business account and personal expenses from your own, so the books show two separate sets of finances. Move money between the accounts only through clear owner draws or deposits, and keep a record of each transfer.

How to form your LLC step by step

Four administrative steps convert a sole proprietor into a functioning LLC. Each depends on the preceding one, because state registration comes first and the bank account requires the federal tax identification number. Most of the effort concentrates in the filing and documentation, while the remaining steps demand comparatively little time. The sections below follow that order. Costs vary by state, so check your state's business filing office before you start.

Choose your state and name

For a solo business, the right state is almost always the one where you live and work. Forming in Delaware or Wyoming rarely helps, because you would usually still have to register as a foreign LLC at home. That means paying formation fees in two states while using only one. Your name must also be distinguishable from businesses already on the state's records. Search the state's business database before committing to a name, and verify that a matching domain name is available if you plan to build a website.

File the articles of organization

This document, called a certificate of formation in some states, creates the LLC. Filing fees range from $35 in Montana to $500 in Massachusetts, and New York also requires new LLCs to publish a notice of formation in two newspapers for six consecutive weeks. Every LLC needs a registered agent with a state address, which can be you. If you serve as your own agent, confirm your state's requirements for the agent's address and availability, since the state sends legal notices there. Some freelancers hire a commercial registered agent

instead, which adds a yearly cost.

Get an EIN and a business bank account

An Employer Identification Number [EIN] from the Internal Revenue Service [IRS] is free and takes minutes to get online. The online application asks for the Social Security number or individual taxpayer identification number of the responsible party, and it must be completed in a single session. Most banks ask for an EIN before opening an LLC account, and it lets you put an EIN on Form W-9 instead of your Social Security number. That second benefit keeps your Social Security number out of the hands of every client that requests a W-9. Bring your formation documents to the bank, since the institution will usually require evidence that the LLC legally exists.

Write an operating agreement

Only a handful of states, including California and New York, require LLCs to have an operating agreement. Writing one anyway is wise. It shows that the LLC operates as a separate business and spells out what happens if you add a partner or close the company. A single-member agreement can be short, covering who owns the company, how you take money out and who decides what happens if you cannot run the business. Store it with your formation documents and amend it whenever ownership changes.

What happens to your taxes

For many freelancers, the biggest surprise is how little changes at first. The IRS treats a single-member LLC as an entity disregarded as separate from its owner by default.3 As a result, you still report business income on Schedule C and pay self-employment tax. Quarterly estimated payments continue as before. One exception applies to employment tax, where the IRS still treats a single-member LLC as a separate entity, and that matters once you hire help.

The bigger difference is optional. An LLC can elect to be taxed as an S corporation, which lets you pay yourself a reasonable salary and take the remaining profit as distributions that are not subject to self-employment tax. Because the election adds payroll and bookkeeping costs, it usually pays off only once profits are steady and substantial. An LLC that wants corporate treatment can also file Form 8832, and the election generally cannot take effect more than 75 days before the filing date or later than 12 months after it. Evaluate the election

with an accountant, using your actual profit, before you commit.

Ongoing costs to plan for

Most states require an annual or biennial report with a fee, and some charge far more than others. California, for example, requires every LLC doing business or organized in the state to pay an annual tax of $800, due on the 15th day of the fourth month of the tax year.4 LLCs with California income above $250,000 also owe a fee that starts at $900 and rises with income. Add the state report, any franchise tax and insurance premiums to your annual budget, along with the registered agent fee if you hire one.

Missing these deadlines can lead to penalties or even administrative dissolution, which removes the liability protection you formed the LLC to get. Calendar reminders for each due date cost nothing and prevent most problems. Set one reminder for the state report, one for any franchise tax and one for each quarterly tax payment. Review the schedule annually, because state fees and filing requirements can change.

- 1Launch your business - Small Business Administration
- 2Piercing the corporate veil
- 3Limited liability company (LLC) | Internal Revenue Service
- 4Limited liability company | FTB.ca.gov

Summary

Freelancers do not need a limited liability company [LLC] on day one, but they need one once risk, contracts or income justify a clear legal line between work and personal assets. The company shields you from business debts and disputes, not from your own errors, and only while you keep the finances separate. Choose your home state, file the articles of organization, obtain an Employer Identification Number [EIN], open a business bank account and write an operating agreement. Taxes change little at first, and the S corporation election can wait until profit is steady. Annual reports and fees keep the protection alive, so calendar every deadline. Treat the LLC as a structure that needs upkeep, not a one-time filing.