



**Association of Fitness Studios:**

# Establishing a Legal Business Entity for Your Fitness Business



*"At AFS one of our biggest priorities is connecting our members so they can leverage the combined experiences of each other to maximize their growth potential."*

– Josh Leve, Founder & CEO, Association of Fitness Studios



**ASSOCIATION OF  
FITNESS STUDIOS**

# Establishing a Legal Business Entity for Your Fitness Business

When it comes to forming a legal business entity there are several options to choose from, and in most cases seeking the assistance of a legal professional to help you with the decision is advised. Our objective is to provide insights into your options, along with general guidance on how to properly establish a legal entity for your studio, with the caveat that it is always best to retain a legal professional to guide you through the process.

## What are the Options for your Legal Entity?

In general there are five options to select from when establishing your legal structure. These five options all have their benefits and risks. What follows is a brief overview of each option.

- **Sole Proprietorship (SP).** A sole proprietorship is the most basic business structure. A sole proprietorship has no formal legal requirements and always has a single owner, the individual who is creating the business. As a sole proprietor you can reference the business under your own name or indicate you are “doing business as” (d.b.a.) under a specified name. If you decide to go into business as a sole proprietorship and operate under a d.b.a., then you will be required to file for a certificate “for doing business as” with your state government. Operating as a sole proprietorship has few if any advantages for a studio owner, and lots of disadvantages; the most significant of those disadvantages being:
  - The business has no insulation from liability, and all liability and debt become the personal responsibility of the owner. If legal action is brought against your business then your personal assets are at risk.
  - The business will terminate upon the death or incapacity of the individual who is the owner.

If your intent is to operate a fitness studio and lease space then a sole proprietorship becomes even more of a risk, since you would be personally responsible for the lease.

- **Partnerships.** Partnerships are designed to be a simple business structure for companies that have more than one owner. There are two general types of partnerships; general partnerships and limited partnerships.
  - **General partnership (GP).** General partnerships require relatively little legal assistance to be formed and the taxes from the business enterprise are “pass through,” meaning they are only taxed once. A general partnership can be written, oral, or implied. A general partnership typically consists of two or more individuals doing business as co-owners. In a general partnership, each partner is an agent of the partnership and can legally bind the other partner to any agreement entered into by the other partner on behalf of the business. In essence each partner has joint and severable liability, meaning that one individual or all of the individuals can be held accountable for the debt and legal liability of the business. Finally, either partner has the ability to dissolve the partnership at any time.
  - **Limited partnership (LP).** Limited partnerships require a legal agreement between the involved parties and a certificate of limited partnership. Limited partnerships have a general partner who typically manages the business, and in many instances also has the largest financial investment in the business. This legal structure allows there to be limited partners, individuals who have a financial stake in the business, but who are not involved in managing it. In a limited partnership, the partners can be individuals or corporations. Limited partnerships are similar to general partnerships in that the partners have joint and severable liability. A limited partnership exists as long as the general partner is involved, or until all partners agree to terminate the arrangement. A limited partnership is one



option a studio owner might consider if the intent is to have multiple stakeholders in the business and the entrepreneur intends to have the largest stake in the business. If the entrepreneur will not be the majority owner then a limited partnership may not be the best solution.

- **Corporations (C-Corp).** Corporations, also known as C-Corps, are legal entities that provide significant and substantial liability protection for the owners, also known as shareholders. It should be noted that individual owners are not shielded from liability in instances where they provide a personal guarantee for a bank loan. C-corporations tend to be the legal structure of choice for larger companies, primarily due to issues revolving around liability and taxation. The disadvantage of a C- corporation and the primary reason why an independent studio

with one or more owners would not want to operate under this structure is the issue of double taxation. A C-corporation is taxed twice; first the profits of the company itself are taxed and second, any income generated by the shareholders (for example salaries and/or profit distributions) is taxed at the individual level. When a corporation is formed, it must file articles of incorporation with the State in which it intends to have an office. The articles of incorporation must include a listing of the owners, directors, and officers. A corporation is required to have both bylaws and annual meetings of its directors and officers, with the directors and officers representing the owners. Corporations may issue stock, both common and preferred. Stock enables individuals and organizations to have an ownership stake in the business. A corporation may exist for perpetuity.

- **S Corporations (S-Corp).** An S corporation is a hybrid corporation that combines the features of various business structures. An S-Corp provides owners or shareholders with limited liability for corporate activities, including legal issues and debt. Another upside of an S-Corp is the benefit of pass through taxation which means income is taxed once when it is passed through to each of the respective owners (e.g. payroll and/or ownership distribution). For a studio owner, whether as the sole owner or as one of several owners, an S-Corp is an attractive option. You should consult with a legal professional, as well as an accountant before pursuing this structure.
- **Limited Liability Corporation (LLC).** An LLC combines elements of a corporation, a sole proprietorship, and partnership structure to create a dynamic and flexible legal entity that is well-suited for individual owners as well as multiple owners. An LLC insulates the owner(s), referred to as members, from the legal liabilities of the business, with the exception of when an owner provides a personal guarantee for a loan. LLC's also provide the business itself with limited liability. LLC's provide the same tax benefit for owners as does an S-Corp, meaning that taxes are passed through to the individual owner(s). The owners of an LLC can choose to be taxed as partners or as an S-Corp, or as a sole proprietor if owned by a single individual. LLC's do not have to hold meetings of the shareholders or maintain minutes of meetings (a requirement of a C-Corp). For a studio owner, whether as the sole owner or as one of several owners, an LLC is an attractive option. You should consult with a legal professional, as well as an accountant before pursuing this structure. While it has numerous advantages, your local accountant and attorney may feel your business would be better served under another legal structure.

### **Some Things to Think About when you file for Legal Status**

Selecting the legal structure for your new business is just the first step in the process. Once you have determined what legal structure is best for your business, then you need to address some other key decisions. While these issues may differ slightly from state to state, the major ones are similar no matter where you form your business. Following is a list of issues you should carefully consider as you form your new legal entity.

- **Identify the legal name for your business** (you may want to complete a branding exercise before doing this).



- *Identify a registered agent and registered office for your business.* A registered agent is someone that is designated to officially receive and send legal papers on behalf of your business entity. If you are forming an LLC or C-Corp this is a requirement. While you can identify yourself or a business partner to be the registered agent, it is advisable to select your attorney or accountant to be your registered agent with the state.
- *Identify the owner(s) of the legal entity.* If you plan to be the sole owner it's easy, but if you will have partners or shareholders (members in an LLC) then you must address this in the formation of your legal entity.
- *Create a company agreement.* This is a legal document that provides specific details about your company, including how decisions will be made, how owners will interact, and in the event an owner wants to get out, how that will be addressed. If you file online they will provide a basic agreement, but it is better to meet with an attorney and make sure the agreement addresses the needs of the ownership group.

Once you complete your filing the state will forward you a Certificate of Filing and later a Certificate of Formation.

### **Obtaining a Federal Tax ID (Employer Identification Number) for Your Business**

Once you have established a legal business structure the next step is to file for a federal tax identification number (EIN). Your EIN is your business' "social security number." Your EIN is your business' fingerprint and is the means by which the government keeps tabs on you. Once you have your Certificate of Formation as a legal entity then you can file for your EIN, either online through the government [www.irs-tax-id.com](http://www.irs-tax-id.com) or through your attorney or accountant. The process only takes minutes when done online and once you are registered, the government will provide confirmation of your Federal EIN. Your Federal EIN is used in a variety of ways, including:

- When you open a bank account of your business
- When paying taxes for employees you hire
- When filing your local, state and federal tax returns for the business
- When completing various government forms such as a W-9
- When setting up accounts with suppliers

Establishing a legal structure for your business is critical. The type of legal structure you create can have both short term and long term implications, some of which could impact you personally for a considerable period of time. As a result, the process of filing for legal status as a business is not something you, and your partners, if any, should take lightly.



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