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CHOOSING THE RIGHT BUSINESS ENTITY

Your business can be operated as a sole proprietorship, partnership, corporation, or limited liability company ("LLC"). Choosing the right entity for your business involves several factors, which are briefly summarized below.

1. Sole Proprietorship: A sole proprietorship is where one person owns a business without having a separate "business entity." This is the simplest way to own a business, but the owner is personally liable for all of the debts of the business.

2. Partnerships: Two or more people can own a business together as a partnership. A written Partnership Agreement is ordinarily used to spell out the relationship between the partners. The partners split the profits and expenses of the business equally, or according to an agreed-upon formula. Partnerships are "pass through" entities for income tax purposes, which means that the partners individually report their share of the business profits and expenses on their personal income tax returns. There are two types of partnerships:

   A. General Partnership: Each of the individual partners is personally liable for the debts of the partnership;

   B. Limited Partnership: In a limited partnership, only one partner, called the "general partner," is personally liable for the debts of the partnership. The other partners, called "limited partners", can avoid personal liability for most or all of the partnership debts.

3. Corporations: A corporation is a business organization that is owned by one or more shareholders. A corporation is legally separate and distinct from its shareholders, so the shareholders are ordinarily not personally liable for the debts of the corporation. There are, however, exceptions to this, such as where a shareholder personally guarantees the debts of the corporation, or fails to follow certain corporate "formalities." There are two basic types of corporations:

   A. "C" Corporations: "C" corporations must file corporate income tax returns, and pay income tax on profits of the business. Any profits remaining after payment of taxes can be distributed to the shareholders, who must report those distributions as income on their personal income tax returns. Thus, "C" corporations involve double taxation, because both the corporation and the shareholders pay income taxes on the profits of the business.

   B. "S" Corporations: "Subchapter S" corporations are not subject to double taxation, because the corporation itself does not pay income tax on its profits. Instead, the profits "pass through" to the shareholders, so income taxes are paid only once on corporate profits.

4. Limited Liability Companies: Like corporations and limited partnerships, "LLCs" can insulate the owners from personal liability for the debts of the business. LLCs are slightly more expensive to charter than corporations, but they can be operated without all of the corporate formalities, so are sometimes even more effective then corporations in protecting the owners from personal liability. A "Series" LLC can own multiple businesses or properties, each of which can be insulated from the debts of the others. LLCs are "pass through" entities for tax purposes, so there is no double taxation on business profits. Both corporations and LLCs can be owned by a single shareholder.

This is only intended as a simple guide to understanding the different types of business entities. You should consult with your attorney and tax advisor for specific advice.

Prepared by James D. Skaar
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