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Business Ownership Structures

When you are thinking of starting your business operation, it is essential that you determine what structure you choose and whether it is the best one for your circumstances at the time. Here is a brief introduction to the most common structures available to you:

- sole proprietorship
- partnership
- limited partnership
- limited liability partnership
- corporation

Each o f these is explained below. You will notice that there are offshoots of some of these – hybrids as I refer to them. In later paragraphs, the advantages and disadvantages of each structure will be discussed.

Sole Proprietorships

A sole proprietorship is a one person operation that is usually not registered with the state. You are not required to file any papers or do anything special. You just start to operate –offer a service or sell a good. Of course your particular jurisdiction, the state, city or county may require you to obtain a permit or a license to offer that particular service or sell that special good.

Partnerships

A partnership is a business owned by two or more persons who have not filed papers to become a corporation. Written or unwritten, legally an agreement that involves two or more persons is deemed by law to be a partnership unless papers to become a corporation are filed.

Limited Partnerships

A limited partnership is an extension of a partnership with certain defined rules One partner - the general partner- is responsible for the operation of the partnership The others are investors with very limited control over decisions.

Limited Liability Partnerships

A limited liability partnership is a partnership whose partners are not personable liable for any of the other partner's liabilities and who are not personally liable for certain other liabilities. It is simply a partnership, as defined before, but with some additional legal protections. This structure is usually reserved by the state for professional entities such as Certified Public Accounting (CPA) firms.

Corporations

A corporation is a collection of persons or a collection of entities which have joined together as one entity. That entity is sometimes referred to as a separate person. It is an independent legal entity and, its affairs, debts and any violation of law cannot ordinarily affect any of its individual owners. There are many types of corporations including Non profit, Subchapter S, and LLCs.

A nonprofit corporation operates for charitable, educational, religious, literary, or scientific purpose. They may earn a profit on their operations but none of that profit may inure to the benefit of any person or persons. That profit must be channeled into other nonprofit operations. Properly sanctioned it is not taxed, and the donors to its purposes are given tax benefits by the Internal Revenue Service

A subchapter S corporation is a special structure allowed by the Internal Revenue Code where each person or entity in the collection of persons or entities may have the income or loss from this corporation reported on his or her, or its income tax return. LLCs are like corporations in certain ways and like partnerships in other ways. This concept will be easier understood when the pros and cons of each business structure is discussed later.

ADVANTAGES AND DISADVANTAGES OF A BUSINESS STRUCTURE					
	SOLE PROPRIETORSHIP	PARTNERSHIP/ LIMITED	LIMITED LIABILITY COMPANY (LLC)	S CORPORATION	C CORPORATION
Legal Liability	Unlimited	Unlimited to general partnership, limited to RLLP	Limited, same as LLP or corporation	Limited	Limited
Continuity of the Entity	Limited to life of proprietor	Limited, unless provided for in partnership contract	Dissolve date	Perpetual Life	Perpetual Life
Acquisition of Capital	Limited to only what the proprietor can secure	Generally limited to what partners collectively can raise	Generally limited to what members collectively can raise	Maximum of 75 stockholders but capital generally not raised by selling stock	Unlimited number of stockholders but capital generally raised by selling stock
Transfer of Interest	Easy because all assets owned by individual proprietor	Right to distributions easy to transfer; interest in assets and right to management cannot be transferred without consent of other partners	Economic rights are transferable, management rights transferable with consent of other members	Stock easy to transfer unless restricted by agreement, by articles of incorporation or by being statutory close corporation	Stock easy to transfer unless restricted by agreement, by articles of incorporation or by statute
Management	All management decisions by proprietor	Usually all general partners will be actively involved in management activities	Usually managed by members but can have separate managers with duties as outlined by the operating agreement	Managed by directors who are elected by shareholders unless statutory close corporation has chosen to eliminate directors	Managed by directors who are elected by shareholders unless statutory close corporation has chosen to eliminate directors
Taxation of Income and Expenses	All income and expenses reported on proprietor's individual tax return	Divided among partners in accordance with investment or partnership agreement and reported on partners' individual returns	Divided among members in accordance with investment or operating agreement and reported on members' individual returns	Passed directly through to the shareholders according to the amount of stock held. Generally no income tax paid by corporation	Taxed separately at the corporate level, again at the shareholder level if distributed as a dividend
Liquidation of Entity	At the discretion of the proprietor, treated as sale of individual assets	Required upon withdrawal of a partner unless partnership agreement permits business continuation	Same as partnership	Normally a two-thirds vote of shareholders is required	Normally a two-thirds vote of shareholders is required
Major Advantages	Independence, flexibility, minimum of legal requirements	Additional management input and operational responsibilities shared, additional capital and equity available, flexibility, shared overhead means increased profits, limited liability with RLLP	Same as partnership plus limited liability without having to file annual document, can be treated as any business form for income tax purposes	Limited liability, profits taxed once, direct pass through of income and expenses to shareholders	Limited liability, can offer fringe benefits to owners and deduct them for income tax purposes
Major Disadvantages	Unlimited liability, limited life, limited management ability, limited investment potential	Unlimited liability unless RLLP, annual renewal filing to keep RLLP, limited, relations among partners can cause problems, changes of partners or partnership agreement may be difficult	Relations among members can cause problems, changes of members or operating agreement may be difficult	Not every corporation can qualify, cannot deduct fringe benefits for owners or their families, relations among shareholders or directors can cause problems	Difficult to get assets out or to sell business without double tax, relations among shareholders or directors can cause problems