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# Choosing The Proper Legal Structure For Your Business

One of the most important decisions people make in starting a business is choosing the legal form. When selecting the form for your business, it's important to consider several factors, including how hard it is to create and maintain the enterprise, management and control issues, the importance of limiting liability, and tax factors.

The main business forms are the sole proprietorship, partnership, corporation and limited liability company. For many businesses, each form is available. However, legal and practical factors may require a particular form at a certain time. As conditions change, switching to a different form may be desirable. Here is a brief summary of each form taking into account the factors mentioned above.

### *Sole Proprietorships*

Sole proprietorships are the most common business form. They are businesses owned and operated by one person. The sole proprietor manages and controls the business alone. He or she bears all losses and keeps all profits.

Sole proprietors are personally liable for their own acts and the acts of employees. Liability extends to all the proprietor’s assets.

Sole proprietors are taxed like any other person. The proprietor’s business income and other income, and business losses and other losses, are treated together.

### *Partnerships*

Partnerships involve two or more co-owners of a business. The two main kinds of partnerships are general and limited.

• General partnerships. General partnerships are formed by all general partners. They can be formed easily. No written agreement is required, although it is strongly advised to have one.

Unless the partners agree otherwise, profits and losses are split equally and each partner has an equal voice in managing the business. Also, each partner is personally liable for partnership obligations.

The general partnership itself does not pay income taxes. Rather, the partnership's gains or losses flow through to each partner based on his or her share.

• Limited partnerships. Limited partnerships consist of at least one general partner and one limited partner. General partners manage the business while limited partners have a passive role.

A limited partner's liability is limited to the amount of money he or she contributed. General partners are personally liable for all partnership obligations.

Like general partnerships, limited partnerships pay no income taxes. Rather, partners are taxed on their share of the business's profits or losses.

### *Corporations*

A corporation is a separate, formal legal entity. It is owned by shareholders who elect a board of directors. The board of directors appoints officers to run the corporation on a daily basis.

A key benefit of forming a corporation is the limited liability enjoyed by shareholders. A shareholder's liability is limited to the amount he or she invested. Also, shareholders have a voice in management, since they elected the board of directors. Thus, shareholders have a benefit that people in a partnership do not have — a say in how the business is run as well as limited liability.

One disadvantage of corporations is that there are more legal formalities to follow than for partnerships. For example, regular meetings of shareholders and directors must be held, and minutes of these meetings must be kept. Not following required formalities can result in shareholders being held personally liable for the claims and debts of the corporation.

Corporations are separately taxable entities for tax purposes. The corporation pays income taxes and shareholders pay taxes on dividends (an exception is the "S Corporation", which is taxed like a partnership).

### *Limited Liability Companies*

The newest business form is the limited liability company ("LLC"). LLC's offer the tax benefits of a partnership and the personal liability protections of a corporation. Though this may sound similar to a limited partnership, LLC's offer more flexibility than limited partnerships. For example, unlike limited partnerships, LLC's have no general partner. So no LLC member will be exposed to unlimited personal liability.

LLC's are typically easier to form and maintain than corporations. LLCs are formed by filing a simple certificate with the state and entering into an agreement with the other owners stating how the company will operate. An LLC can be set up so it doesn't need formal meetings.

Selecting the proper form for your business is critical, as it affects issues like control, personal liability, taxes and other issues that directly affect the success of your business. Each of the business forms has advantages and disadvantages. We can review your situation to see which form is best for your business.