Which Legal Entity should I choose for my Business?

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With a check of the box, business owners can choose a tax structure with enormous financial repercussions both now and in the future. Or, they can find themselves in a situation where corporate formalities were not observed, thereby opening the door to personal liability. The choice of business entity is clearly very important. So, is there an easy answer to which entity would be best from a legal, tax, and business standpoint? Unfortunately, no. Which entity to select will depend on a plethora of factors, including the decision to issue securities, the desire to attract investment, the business' management structure, estate planning goals, the number and type of employees, the forms of employee compensation, and the near and long term potential for profit and losses. In this article, we discuss three major points that business owners should touch upon when considering a choice of entity.

1. **Two Levels of Taxation, or One?**

First, business owners should consider what the effects will be of corporate level taxation. It is commonly stated that S Corporations, partnerships, and certain LLCs are superior to C Corporations because they offer "pass-through" tax treatment— i.e., one layer of tax. This is true in many cases: thanks to one layer of tax, shareholders or members of pass-through entities often pay much less tax than C Corporation shareholders.

Proponents of C Corporations often counter by citing the deductions which are available to the corporation for employee wages, or the current low rates of capital gains taxation available to shareholders. The tax structure could also be seen as an incentive to hold profits at the corporate level to support growth and re-investment. However, the IRS has tools to discourage the payment of unreasonably high wages for tax advantage in a C Corp, just as they have tools to discourage unreasonably high distributions in an S Corp. Also, there is no guarantee that long term capital gains rates will remain low. A C Corporation may be a superior entity for attracting investment, but the use of other entities early on in the business' life should not be overlooked. Ultimately, it may be a loser's game to try to manipulate the tax system to make a C Corp work when a different entity is more appropriate.

2. **Do you Have the Time or the Temperament to Observe Corporate Formalities?**

Second, business owners should consider how their business operates and what business structure would be the best fit for their particular needs. Constantly, small business owners are failing to observe corporate formalities by maintaining corporate minutes, resolutions, and other

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records. In some cases, this may be exposing owners of businesses to liability for litigants who seek to "pierce the corporate veil" and reach shareholders directly. In some cases, business owners are doing themselves an enormous favor by choosing a legal entity that requires minimal corporate formalities.

With an LLC, for instance, a business operating agreement can be customized to the business' particular needs. It is a rare member-manager who wishes to maintain each and every corporate formality, and that's not a problem with an LLC. The operating agreement may specify that certain records need not be kept. This can save owner-managers a lot of time and money in producing corporate records. It also can prevent veil piercing by litigants.

Third, business owners also need to consider the money. Are there current profits or losses? If there are multiple owners, would one owner benefit from recognizing losses, while the other could stand to recognize more gain? What is the long term potential for profits and losses? These issues will heavily influence the ultimate choice of entity. With an LLC, for instance, members can recognize both pass through gains and losses. The operating agreement can also be customized to allocate gain to one member, and loss to another.

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