# Sole Proprietorship
# Partnership
# Corporation
# Limited Liability Co.

## Which is right for you?

***Often, the first business decision you'll***

***Make can be the most difficult of all. . .***

One of the first executive decisions you'll make for your new business is deciding what organization is best for you. There are four ways to organize your business. Listed from the simplest to the more sophisticated are:

- Sole Proprietorship
- Partnership
- Corporation
- Limited Liability Company

**Sole Proprietorship**

A sole proprietorship is, as the name suggests, a business with one owner. Of the four types of organization, a sole proprietorship is the most common. A business organized as a sole proprietorship is not separate from its owner, but merely a different name with which the owner represents him/herself to the public. The owner is the business and the business is the owner. They're inseparable.

Because of this relationship, a sole proprietorship is known as a pass-through entity. This means that all income and expenses pass-through to the owner and are filed as part of the owner's personal return. If there is a business loss, the owner will enjoy a deduction to offset personal (paycheck) income. However, if the business makes a profit, the owner is responsible for any taxes due.

Since they have few legal requirements, sole proprietorships are easy to form and operate. They can also be more affordable since no legal documents need to be filed in most cases. Basically, all one has to do to form a sole proprietorship is get a business license and begin operations.

Although the sole proprietorship does have the advantage of simplicity, the negatives can steer entrepreneurs away from this form of a business organization. The disadvantages of a sole proprietorship stem from its very nature - the business and the business owner are inseparable. This leads to three potential problems.

First, owners can lose some lucrative tax-free fringe benefits because they cannot participate in company funded employee benefit plans like medical insurance and retirement plans. Second, since the owner and the business are inseparable, whoever sues the business actually sues the owner. The owner's personal exposure is unlimited. Finally, the business owner is personally liable for the debts of the company and unfortunately, personal assets can be taken to pay company obligations.

**Partnership**

A partnership is similar to a sole proprietorship but has two or more owners. Like the sole proprietorship, the partnership is not a separate legal entity from its owners. Unlike the proprietorship however, the partnership can hold property an incur debt in its name.

In general, the partnership shares the same advantages and disadvantages as the sole proprietorship. However, the partnership has an additional drawback. A partner can be held liable for the acts of the other partners, increasing personal liability.

Tax treatment of the partnership is also slightly different. Although it is a pass-through entity and does not pay its own income tax, the partnership does file an informational tax return with the IRS. The pro-rata share of its income and expenses are shown on each partner's personal return, and any taxes due are paid by the partners.

**Corporation**

The corporation was conceived to solve the typical problems of the partnership. Incorporating allows a group of entrepreneurs to act as one, much the way a partnership does, with one important advantage. Since the corporation is a separate legal entity capable of being sued, it can protect its owners by absorbing the liability if something goes wrong. In recent years, the corporation has developed as a tax reduction/planning tool.

A corporation is essentially an "artificial person" created and operated with the permission of the state where it is incorporated. It's a person like you, but only "on paper." A corporation is brought to life when a person, the incorporator, files a form with a state known as the articles of incorporation. The owner of a corporation is known as a shareholder.

Since a corporation is a separate legal entity, the corporation actually owns and operates the business on behalf of the shareholder, under the shareholder's total control. This separation provides a legal distinction between the owner and the business and provides three important benefits:

1. It allows you, the owner, to hire yourself as an employee (typically as president) and then participate in company funded employee benefit plans like medical insurance and retirement plans.
2. Since you and you company are now two separate legal entities, lawsuits can be brought against your company instead of you personally.
3. When debt is incurred in the company name, as a separate legal entity, you are not personally liable and your assets cannot be taken to settle company obligations.

**S Corporations**

An "S" corporation is the same as any other business corporation with one important difference - IRS allows it to be taxed like a partnership, a pass-through entity.

When business corporations are created, they are all regular "C" corporations. This special filing status is elected by filing IRS Form 2553. Many people begin corporate life as an S corporation when there are losses to offset their "paycheck" income and then revert to a C corporation status when the corporation begins to make taxable profits. It is important to remember that being an S corporation is a tax matter only.

**Limited Liability Companies**

A limited liability company is the newest form of business organization. Available in 49 states, it's a hybrid entity that has favorable aspects of both the corporation and partnership structures. The LLC features pass-through taxation of the partnership, and limited liability of the corporation. You may choose to see it like this - the LLC is a partnership that offers the limited liability protection of a corporation. Or conversely, it's a corporation that's taxed like a partnership. Yes, it is much like an S corporation without the 35-shareholder limitation.

The limited liability company is a promising type of business entity, but it does have a couple of disadvantages. First, its newness means that law regarding LLC is still evolving and some issues regarding operation remain unsettled. Also, if the LLC is taxed as a partnership, business owners will lose some company funded benefits.

To decide what type of business entity is best for you, refer to the chart below.

| | **Sole Proprietorship** | **Partnership** | **Corporation (S or C)** | **LLC** |
|---|---|---|---|---|
| Best Suited For | Single owner business where taxes or product liability are not a concern. | Business with partners where taxes or product liability are not a concern | Single or multiple business owner(s) who need limited liability and want the company to fund fringe benefits. | Single or multiple business owner(s) who need limited liability but want to be taxed as a partnership |
| Type of Entity | Inseparable from owner | Inseparable from owner but can have debt or property in its name | Separate legal entity | Separate legal entity |
| Main Advantages | Inexpensive to set up.<br>Few administrative duties. | Inexpensive to set up.<br>Few administrative duties. | Limited liability.<br>Company paid fringe benefits. (C Corp)<br>Tax savings through income splitting. (C Corp)<br>Capital is easy to raise through sale of stock. | Limited liability.<br>Pass-through entity.<br>Unlimited number of owners.<br>Capital is easy to raise through sale of interests. |
| Main Disadvantages | Unlimited liability.<br>No tax benefits.<br>Business dissolves upon death of owner. | Unlimited liability, also liable for partner's acts.<br>No tax benefits.<br>Legally dissolves- change or death of partner. | Can be costly to form.<br>More administrative duties.<br>S corp. limited to 75 shareholders. | Can be costly to form.<br>More administrative duties. |
| Taxation | Owner is responsible<br>File Schedule C with Form 1040. | Partners are responsible<br>File Form 1065 | C Corp pays its own<br>File Form 1120<br>S Corp passes over to its stockholders<br>File Form 1120S | Usually taxed as a partnership, but can be taxed as a corp. in some states.<br>Usually Form 1065 |