BUSINESS STRUCTURES 101

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WHAT IS A BUSINESS STRUCTURE?

Business structure refers to the legal structure of an organization that is recognized in a given jurisdiction. An organization's legal structure is a key determinant of the activities that it can undertake, such as raising capital, responsibility for obligations of the business, as well as the amount of taxes that the organization owes to tax agencies.

Before making a choice on the type of legal structure, business owners should first consider their needs and goals and understand the features of each business structure. The four main forms of business structures in the United States include sole proprietorship, partnership, limited liability company, and corporation.

SOLE PROPRIETORSHIP

A sole proprietorship is the simplest business structure and involves one individual who is responsible for the day-to-day operations of the business. Also, from a tax perspective, the incomes and expenses of the business are included in the tax return of the owner.

The business is not required to file separate income tax forms from the owner since the business does not exist as a separate legal entity from its owner. The owner is required to file Form 1040, and the form must include Schedule C and Schedule SE for self-employment tax.

There are several advantages to opting for a sole proprietorship business structure. First, it is inexpensive to start, and there are minimal fees incurred when registering a sole proprietorship. In most states, the only costs associated with running a sole proprietorship are business taxes and operating license fees.

Business owners may also be eligible for tax deductions, such as health insurance. Unlike a limited liability company, a sole proprietorship is not required to meet ongoing requirements such as shareholder meetings and voting or election of directors. On the downside, since it is not a separate legal entity from its owners, the owners will be personally liable for the debts, liabilities, and obligations of the business.

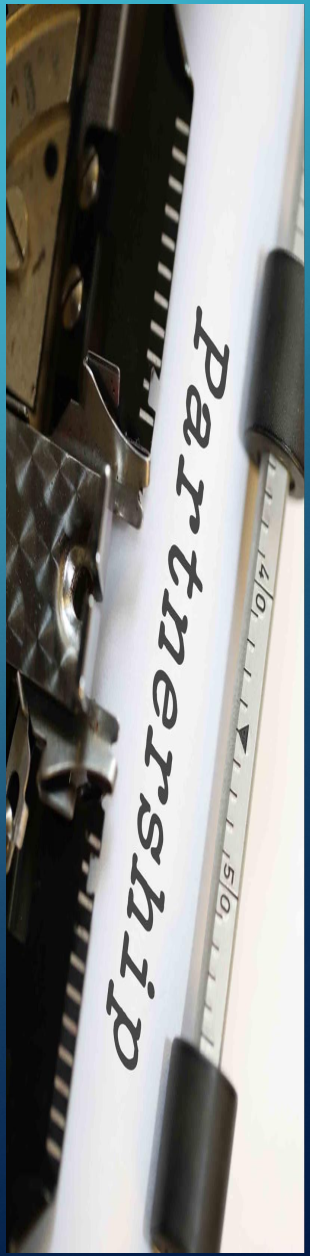
PARTNERSHIP

A partnership is a form of business structure that comprises two or more owners. It is the simplest form of business structure for a business with two or more owners. A partnership shares a lot of similarities with a sole proprietorship. For example, the business does not exist as a separate legal entity from its owners, and therefore, the owners and the entity are treated as one person.

When filing taxes, the profits and losses of the business are passed on to the partners, and each partner is required to report the information in Form 1065 with their personal tax returns. Also, partners are required to pay self-employment tax, depending on their share of the enterprise's profits. Schedule K-1, which records the profits or losses, should accompany Form 1065.

A partnership business structure offers several advantages. When registering a partnership, there is little paperwork involved, and the partners are not required to meet the same level of requirements that limited liability companies are subjected to. Also, partnerships enjoy a special taxation arrangement, where partners are required to report their share of profit or loss of the business on their income tax return.

On the downside, the partners are personally liable for the debts and obligations of the business, and their personal assets can be sold off to pay the business debts. Also, disagreements may occur between the partners and this may slow down the operations of the business.



CORPORATION

A corporation is a type of business structure that gives the entity a separate legal entity from its owners. It is complex and expensive to set up, and it requires the owners to comply with more tax requirements and regulations. Most corporations hire attorneys to oversee the registration process and to ensure that the entity complies with the state laws where it is registered.

When an organization intends to go public through the issue of common stock to the public, it must first be incorporated as a corporation. Corporations are required to pay both federal and state taxes, while the shareholders are required to disclose their dividend payments when filing their personal income taxes.

The main types of corporations are C-corporation and S-corporation. A C-corporation exists as a separate legal entity from its owners, whereas an S-corporation may consist of up to 100 shareholders and functions in the same way as a partnership.

One of the advantages of a corporate structure is the ability to raise capital. The entity can raise large amounts of capital by selling shares of stock to the public. Also, the business structure comes with limited personal liability, offering the owners protection against debts, liabilities, and obligations of the business.

On the downside, a corporation is subject to more requirements, such as meeting, voting, and the election of directors, and it is more expensive to form compared to a sole proprietorship or partnership.

LIMITED LIABILITY COMPANY (LLC)

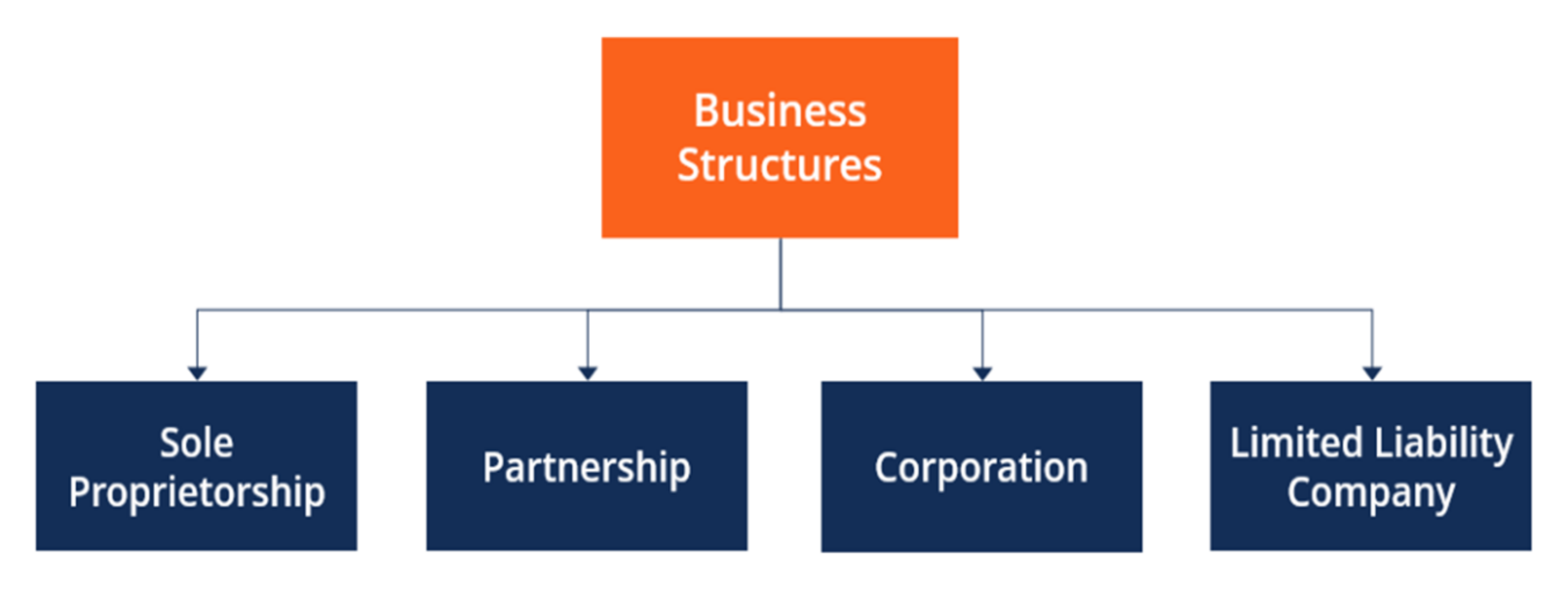
A limited liability company (LLC) is a hybrid business structure that combines the best of both worlds, i.e., it possesses the characteristics of both partnerships and corporations. It provides personal liability protection to business owners while reducing tax and business requirements. The profits and losses of the business are passed through to the owners, and each business owner is required to include a share of the profits/losses in their personal tax returns.

Also, unlike an S-corporation, which is subject to a limit of 100 shareholders, there is no limit to the number of shareholders in a limited liability company. When registering a limited liability company, the entity must file its articles of association with the Secretary of State where it intends to do business. In some states, the entity may be required to file an operating agreement.

One of the advantages of setting up a limited liability company is that it comes with fewer requirements compared to a corporation. Less paperwork is involved, and the owners enjoy limited liability, which protects their assets from being sold to pay liabilities of the entity. A limited liability company is not subject to any limitation on the number of shareholders it can appoint.

On the downside, a limited liability company is expensive to set up since it must register with the state where it intends to conduct operations..

BUSINESS STRUCTURE AT-A-GLANCE



Summary

A business structure describes the legal structure of a company that influences the day-to-day operations of a business.

A sole proprietorship and partnership are simple to set up since they are not required to meet ongoing requirements such as shareholder meetings and voting.

A corporation and a limited liability company provide limited liability protection to their owners, which serves to prevent the owner's personal assets from being sold off to settle the entity's debts and liabilities.

ANY QUESTIONS??