Choosing A Business Structure

Selecting the legal structure of your company is a key decision that many startup entrepreneurs overlook. To help familiarize you with the choices, here are the most common options, but it's best to consult with your CPA, accountant or legal advisor before you make a final decision.

Sole Proprietorship

This is the simplest structure, and usually involves just one individual who owns and operates the enterprise. Tax-wise, this structure is appealing because business expenses and income are included on your personal income tax return, and business losses you suffer may offset other income.

Disadvantages: You're personally responsible for your company's liabilities, so your assets could be seized to satisfy a business debt or legal claim. Banks and other financing sources may be reluctant to make business loans to sole proprietorships.

Partnership

In a *general* partnership, the partners manage the company and are responsible for its debts. A *limited* partnership has both general and limited partners. The general partners own and operate the business and assume liability. The limited partners serve as investors only; they have no control over the company and aren't subject to the same liabilities as general partners. This is usually not the best choice for a new business. A partnership does not pay tax on its income but "passes through" profits or losses to the individual partners.

Disadvantages: General partners are personally liable for the partnership's obligations and debt. Each general partner can act on behalf of the partnership, making decisions that are binding on all the partners. Partnerships cost more to set up than sole proprietorships.

Corporation

Incorporating forms a shield between your business and personal assets. It protects your personal assets from any business liability and makes it easier to raise money. There are several forms of incorporation. A regular or C corporation is generally the most costly to form and is usually used by larger businesses.

Disadvantages: Because a corporation follows more complex rules and regulations than a partnership or a sole proprietorship, it requires more accounting, tax and legal services. Owners of the corporation also pay a double tax: Corporations are subject to corporate income tax at both federal and state levels, and earnings distributed to shareholders as dividends are taxed at individual tax rates on their personal tax returns.

To incorporate, contact the secretary of state or the state office responsible for registering corporations in your state. Often, you can find these online at your state government's website. Using a lawyer costs from $500 to $1,000, or you can file for incorporation on your own using books and software.

S Corporation

The S corporation has the liability protection of a regular (or C) corporation. Income and losses are passed through to shareholders and included on their individual tax returns, so there's just one level of federal tax.

Disadvantages: S corporations are subject to many of the same requirements as C corporations, meaning greater legal and tax costs. Restrictions on S corporation stock can hinder efforts to raise capital.

Limited Liability Company (LLC)

LLCs provide the liability protection of corporations, without the double taxation—earnings and losses pass through to the owners and are included on their personal tax returns. Unlike an S corporation, the LLC has no limitation on the number of shareholders. Any member of the LLC can have a full participatory role in the business's operation. To set up an LLC, file articles of organization with the secretary of state in the state where you intend to do business.

Disadvantages: None