Choosing Your Business Structure

**Choosing a business structure should be done with the guidance of your lawyer, accountant and/or financial advisor.*

The type of business entity you choose will mostly depend on three factors:

1. Liability
2. Taxation
3. Record-Keeping.

Here's a quick look at the differences between the most common forms of business structures:

Sole Proprietorship

A sole proprietorship is the most common form of business organization. It's easy to form and offers complete managerial control to the owner. However, the owner is also personally liable for all financial obligations of the business.

Forming a Sole Proprietorship

No formal action is required to form a sole proprietorship. If you are the only owner, this status automatically comes from your business activities. In fact, you may already own one without knowing it. If you are a freelance graphic designer, for example, you are a sole proprietor.
But like all businesses, you need to obtain the necessary licenses and permits. Regulations vary by industry, state and locality.
If you choose to operate under a name different than your own, you will have to file for that business name.

Taxes

Because you and your business are one and the same, the business itself is not taxed separately – the sole proprietorship income is your income.

Advantages	Disadvantages
Easy and inexpensive to form	Unlimited personal liability
Complete control	Hard to raise money
Simplified tax preparation	Heavy burden

Partnership

A partnership involves two or more people who agree to share in the profits or losses of a business. A primary advantage is that the partnership does not bear the tax burden of profits or the benefit of losses-profits or losses are "passed through" to partners to report on their individual income tax returns. A primary disadvantage is liability-each partner is personally liable for the financial obligations of the business.

Although partnership agreements are not legally required, they are strongly recommended and it is considered extremely risky to operate without one.

Types of Partnerships

There are three general types of partnership arrangements:

- General Partnerships assume that profits, liability and management duties are divided equally among partners. If you opt for an unequal distribution, the percentages assigned to each partner must be documented in the partnership agreement.
- Limited Partnerships (also known as a partnership with limited liability) are more complex than general partnerships. Limited partnerships allow partners to have limited liability as well as limited input with management decisions. These limits depend on the extent of each partner's investment percentage. Limited partnerships are attractive to investors of short-term projects.
- Joint Ventures act as general partnership, but for only a limited period of time or for a single project. Partners in a joint venture can be recognized as an ongoing partnership if they continue the venture, but they must file as such.

Forming a Partnership

To form a partnership, you must register your business with your state, a process generally done through your Secretary of State's office.
You'll also need to establish your business name. For partnerships, your legal name is the name given in your partnership agreement or the last names of the partners.
Once your business is registered, you must obtain business licenses and permits. Regulations vary by industry, state and locality.

Taxes

Most businesses will need to register with the IRS, register with state and local revenue agencies, and obtain a tax ID number or permit.
A partnership must file an "annual information return" to report the income, deductions, gains and losses from the business's operations, but the business itself does not pay income tax. Instead, the business "passes through" any profits or losses to its partners. Partners include their respective share of the partnership's income or loss on their personal tax returns.

Advantages	Disadvantages
Easy and Inexpensive	Joint and Individual Liability
Shared Financial Commitment	Disagreements Among Partners
Complementary Skills	Shared Profits
Partnership Incentives for Employees	

Corporation

A Corporation, (sometimes referred to as a C corporation) is an independent legal entity that is created to conduct business. The corporation becomes an entity-separate from those who founded it-that handles the responsibilities of the organization. Like a person, the corporation can be taxed and can be held legally liable for its actions. The corporation can also make a profit. The key benefit of corporate status is the avoidance of personal liability. The primary disadvantage is the cost to form a corporation and the extensive record-keeping that's required. While double taxation is sometimes mentioned as a drawback to incorporation, the S corporation (or Subchapter corporation, a popular variation of the regular C corporation) avoids this situation by allowing income or losses to be passed through on individual tax returns, similar to a partnership. Once a corporation has been established, the members can file a form to become an S corporation if they do so choose.

A corporation (legal entity owned by shareholders. This means that the corporation itself, not the shareholders that own it, is held legally liable for the actions and debts the business incurs. Corporations are more complex than other business structures because they tend to have costly administrative fees and complex tax and legal requirements. Because of these issues, corporations are generally suggested for established, larger companies with multiple employees.
For businesses in that position, corporations offer the ability to sell ownership shares in the business through stock offerings. “Going public” through an initial public offering (IPO) is a major selling point in attracting investment capital and high quality employees.

Forming a Corporation

A corporation is formed under the laws of the state in which it is registered. To form a corporation, you’ll need to establish your business name and register your legal name with your state government. State laws vary, but generally corporations must include a corporate designation (Corporation, Incorporated, Limited) at the end of the business name.
To register your business as a corporation, you need to file certain documents, typically articles of incorporation, with your state’s Secretary of State office. Some states require corporations to establish directors and issue stock certificates to initial shareholders in the registration process.

Taxes

Corporations are required to pay federal, state, and in some cases, local taxes. Most businesses must register with the IRS and state and local revenue agencies, and receive a tax ID number or permit. Unlike sole proprietors and partnerships, corporations pay income tax on their profits. In some cases, corporations are taxed twice - first, when the company makes a profit, and again when dividends are paid to shareholders on their personal tax returns.

Advantages	**Disadvantages**
Limited Liability	Time & Money
Ability to generate Capital	Double Taxing
Corporate Tax treatment	Additional Paperwork

- A hybrid form of partnership, the **limited liability company (LLC)**, is gaining in popularity because it allows owners to take advantage of the benefits of both the corporation and partnership forms of business. The advantages of this business format are that profits and losses can be passed through to owners without taxation of the business itself while owners are shielded from personal liability.

Source: *Start Your Own Business, Entrepreneur magazine and Entrepreneur.com*

Limited Liability Company

A limited liability company (LLC) is a hybrid type of legal structure that provides the limited liability features of a corporation and the tax efficiencies and operational flexibility of a partnership. Unlike shareholders in a corporation, LLCs are not taxed as a separate business entity. Instead, all profits and losses are "passed through" the business to each member of the LLC. LLC members report profits and losses on their personal federal tax returns, just like the owners of a partnership would.

Forming an LLC

Most states have slight variations to forming an LLC, however all adhere to some general principles:

- There are 3 rules that your LLC name needs to follow:
    1. It must be different from an existing LLC in your state
    2. it must indicate that it's an LLC (such as "LLC" or Limited Company")
    3. It must not include words restricted by your state (such as "bank" and "insurance").

  Your business name is automatically registered with your state when you register your business, so you do not have to go through a separate process.

- File your "articles of organization" with the Secretary of State. These articles are a simple document that legitimizes your LLC and includes information like your business name, address, and the names of its members.

- Create an Operating Agreement. Most states do not require operating agreements. However, an operating agreement is highly recommended for multi-member LLCs because it structures your LLC's finances and organization, and provides rules and regulations for smooth operation. The operating agreement usually includes percentage of interests, allocation of profits and losses, member's rights and responsibilities and other provisions.

Taxes

In the eyes of the federal government, an LLC is not a separate tax entity, so the business itself is not taxed. Instead, all federal income taxes are passed on to the LLC's members and are paid through their personal income tax. While the federal government does not tax income on an LLC, some states do, so check with your state's income tax agency.
Since an LLC is not recognized as a business entity for taxation purposes, all LLCs must file as a corporation, partnership, or sole proprietorship tax return. Certain LLCs are automatically classified and taxed as a corporation by federal tax law.

Advantages	Disadvantages_
Limited Liability	Limited Life (when member leaves, the company dissolves)
Less Record Keeping	Self-Employment Taxes
Sharing of Profits	

Cooperative

A cooperative is a business or organization owned by and operated for the benefit of those using its services. Profits and earnings generated by the cooperative are distributed among the members, also known as user-owners.
Typically, an elected board of directors and officers run the cooperative while regular members have voting power to control the direction of the cooperative. Members can become part of the cooperative by purchasing shares, though the amount of shares they hold does not affect the weight of their vote.

Forming a Cooperative

Forming a cooperative is different from forming any other business entity. To start up, a group of potential members must agree on a common need and a strategy on how to meet that need. An organizing committee then conducts exploratory meetings, surveys, and cost and feasibility analyses before every member agrees with the business plan.

Not all cooperatives are incorporated, though many choose to do so. If you decide to incorporate your cooperative, you must complete the following steps:

- File Articles of Incorporation with the Secretary of State. The articles of incorporation legitimize your cooperative and include information like the name of the cooperative, business location, purpose, duration of existence, and names of the incorporators, and capital structure. Once you file with your state business entity registration office and the articles are approved, you should create bylaws for your cooperative.

- Bylaws are essential to the success of your cooperative. Bylaws list membership requirements, duties, responsibilities and other operational procedures that allow your cooperative to run smoothly.

- Create a Membership Application. To recruit members and legally verify that they are part of the cooperative, you must create and issue a membership application. Membership applications include names, signatures from the board of directors and member rights and benefits.

- Conduct a Charter Member Meeting and Elect Directors. During this meeting, charter members discuss and amend the proposed bylaws. By the end of the meeting, all of the charter members should vote to adopt the bylaws. If the board of directors were not named in the articles of incorporation, you must designate them during the charter meeting.

Taxes

Most businesses must register with the IRS, state and local revenue agencies, and obtain a tax ID number or permit. A cooperative operates as a corporation and receives a "pass-through" designation from the IRS. More specifically, cooperatives do not pay federal income taxes as a business entity. Instead, the cooperative's members pay federal taxes when they file their personal income tax. Members pay federal and state income tax on the margins earned by the cooperative, though the amount of taxation varies slightly by state.

Advantages	Disadvantages
Less Taxation	Obtaining Capital through investors
Funding Opportunities	Lack of Membership/Participation
Reduce Costs and Improved Products & Services	
Continuous Existence	
Democratic Organization	

SOURCES
Information gathered from:
https://www.sba.gov/starting-business/choose-your-business-structure