

Sole Proprietor? Partnership? LLC? Which Business Entity is Right for Me?

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Whether you, and your business associates, are forming a local coffee shop or the next big Silicon Valley tech company, most entrepreneurs will have to decide on the type of operating entity that they will use for their business venture.

Sole Proprietorship

In a sole proprietorship, there is no legal distinction between the business and its sole owner. The owner is personally liable for the business' debts, losses, and liabilities. A sole proprietorship is not taxed separately from its owner. All income and losses are treated similar to a pass through entity.

General Partnership

A general partnership is formed when a business has two or more owners. The owners (also known as "partners") are both jointly and severally liable for the business' debts, losses, and liabilities including for actions of the other owner. Each owner has the authority to bind the partnership by his or her actions unless such authority is altered by an agreement among the owners. A general partnership is treated as a pass through entity for taxation purposes.

Limited Partnership

Limited partnerships are formed after filing the required paperwork with the state. A limited partnership is similar to a general partnership, however, at least one owner (the general partner) is subject to unlimited personal liability and must perform the day-to-day management of the business, while the other owners (the limited partners) are subject to less liability and are more passive in their day-to-day management of the business. Generally, a limited partnership will have a written partnership agreement to memorialize the economic and governance rights amongst all of the partners. Similar to a general partnership, a limited partnership enjoys similar pass through taxation treatment of its losses, gains, and other tax attributes.

Limited Liability Company

A limited liability company ("LLC") may be formed when one or more owners (known as "members") file the required paperwork with the state. The members have limited personal liability for the business' debts, losses, and liabilities. The operational authority may be vested in either the members or the managers (similar to the directors of a corporation). LLC's are taxed as a pass through entity with attributes similar to a partnership or a sole proprietorship (if there is only one member of the LLC). However, LLC members may also elect to treat their LLC like a corporation for tax filing purposes by filing the proper tax forms pursuant to the "check the box" rules.

Corporation

A corporation is considered a legal person and a corporation is responsible for all of its actions, debts and taxes. A corporation is owned by its stockholders and is governed by one or more directors that appoint officers to assist with the day-to-day management of the business. Governance of the corporation is more straightforward when compared to the other listed entities, however, it is less flexible. Sometimes a corporation may also implement various agreements (shareholders' agreement, voting rights agreement, registration rights agreement, etc.) amongst its shareholders to further define their economic or governance rights. A corporation pays income taxes at both the entity level and at the stockholder

level.

S – Corporation

An s-corporation is very similar to a corporation in terms of governance and formalities. However, an s-corporation may be treated like a pass-through entity for taxation purposes by making a formal tax election with the Internal Revenue Service. A corporation must elect to become an s-corporation by filing Form 2553 with the Internal Revenue Service within 75 days of the corporation's formation date. After the s-corporation election is made, an s-corporation is restricted from, including but, not limited to: (i) creating multi-tiered classes of stock that provide for different economic rights among the stockholders, (ii) issuing stock to an alien resident or to any stockholder not considered a natural person, and (iii) issuing stock to more than 100 shareholders.

For assistance in determining the right business entity for you, contact Edward Grattan or any of the business lawyers at Tucker Arensberg.