What Business Structure is Best for My New Company?

One of the first decisions that a new business owner will have to make is how the company should be structured. I asked the new SE Minnesota SCORE Chapter Chair, Irv Plitzuweit how he would answer this question from a client. He recommends that “this decision will have long-term implications, so consult with an accountant and attorney to help you select the form of ownership that is right for you.” He suggests that in making a choice, you will want to take into account the following factors to begin making this decision:

► Your vision regarding the size and nature of your business.

► The level of control you wish to have.

► The level of structure you are willing to deal with.

► The business' vulnerability to lawsuits.

► Tax implications of the different ownership structures.

► Expected profit (or loss) of the business.

► Whether or not you need to reinvest earnings into the business.

► Your need for access to cash out of the business for yourself.

There are many factors that must be considered when choosing the best form of business ownership or structure. The choice you make can have an impact on multiple aspects of your business, including taxes, liability, ownership succession, and others. Generally speaking there are just a few basic choices.

**The sole proprietorship** is a simple, informal structure that is inexpensive to form; it is usually owned by a single person or a marital community. The owner operates the business, is personally liable for all business debts, can freely transfer all or part of the business, and can report profit or loss on personal income tax returns.

**The Limited Liability Company (LLC)** is generally considered advantageous for small businesses because it combines the limited personal liability feature of a corporation with the tax advantages of a partnership and sole proprietorship. Profits and losses can be passed through the company to its members or the LLC can elect to be taxed like a corporation. LLCs do not have stock and are not required to observe corporate formalities. Owners are called members, and the LLC is managed by these members or by appointed managers.

**General Partnerships** are inexpensive to form; they require an agreement between two or more individuals or entities to jointly own and operate a business. Profit, loss, and managerial duties are shared among the partners, and each partner is personally liable for partnership debts. Partnerships do not pay taxes, but must file an informational return; individual partners report their share of profits and losses on their personal return. Short-term partnerships are also known as joint ventures.
The C Corporation (Inc. or Ltd.) is a complex business structure with more startup costs than many other forms. A corporation is a legal entity separate from its owners, who own shares of stock in the company. Corporations can be created for profit or nonprofit purposes and may be subject to increased licensing fees and government regulation than other structures. Profits are taxed both at the corporate level and again when distributed to shareholders.

Shareholders are not personally liable for corporate obligations unless corporate formalities have not been observed; such formalities provide evidence that the corporation is a separate legal entity from its shareholders. Failure to do so may open the shareholders to liability of the corporation's debts. Corporate formalities include:

The Sub Chapter S Corporation (Inc. or Ltd.) is identical to the C Corporation in many ways, but offers avoidance of double taxation. If a corporation qualifies for S status with the IRS, it is taxed like a partnership; the corporation is not taxed, but the income flows through to shareholders who report the income on their individual returns.

To learn more about choosing a structure for your company, contact SCORE "Counselors to America's Small Business." These volunteer counselors provide free, confidential business counseling as well as training workshops to small business owners. The fall schedule of SCORE workshops is available through Community Education as well as on the score-rochester.org website. For example, next Tuesday night, the topic will be “How to Choose a Legal Business Entity”.

Dean L. Swanson, Chairperson
South East Minnesota SCORE
c/o Rochester Area Chamber of Commerce
220 South Broadway, Suite 100
Rochester, MN 55904
*Dean is a volunteer SCORE Counselor.