



Structuring Your New Business

By Business Filings Incorporated

There are five common business structures entrepreneurs often consider as they start their businesses: sole proprietorship, general partnership, C corporation, S corporation, and limited liability company (LLC). Which structure is “best” depends on a number of factors, such as the number of owners involved, the present and future goals for the business, whether the owners wish to limit their personal liability, and the desired type of taxation. This article summarizes each business structure based on their formation requirements, taxation, and liability of the owners, and also highlights items that are typically considered to be advantages and disadvantages of each structure. Additionally, there is a reference chart that compares the five structures in a greater variety of areas.

And if you decide to incorporate your business, the final sections of this article describe the steps you need to take and your options—whether you decide to do it yourself, or use the services of an incorporation service provider such as Business Filings Incorporated.

Sole Proprietorship

A sole proprietorship is a business owned and operated by an individual, and can only have one owner. Forming a sole proprietorship is quick, fairly uncomplicated, and relatively inexpensive. The business owner does not need file documents with the state to form the business, he or she may just begin operations; however, you may still need to obtain business licenses and permits.

With a sole proprietorship, the owner and the business are legally considered the same. Because of this, any profits of the business are viewed as personal profits and are taxed on the owner’s personal tax return. Additionally, the assets of the business and owner’s personal assets are legally considered the same. Therefore, personal assets, such as a home or car, could be used to satisfy business debts.

Common advantages of a sole proprietorship include:

- Creation requires relatively little time and expense.
- There are typically few ongoing requirements.
- Many states do not impose a fee for the mere privilege of existing.
- There is no separate income tax filing for the company; income and losses are reported on the owner’s personal tax return.

The primary disadvantage of a sole proprietorship is:

- Because the owner and the business are legally considered the same, the owner is personally responsible for the debts of the company.



General Partnership

A general partnership is an association of two or more persons operating a business for profit. As with sole proprietorships, general partnerships are fairly easy to establish. Like sole proprietorships, partnerships do not have to file formation documents with the state in order to begin operations, as do corporations and LLCs, although they may need state and/or local business licenses and permits to operate.

The profits or losses of the partnership are reported on the owners' personal income tax returns, and any tax due is paid at the individual level. Because the owners of a general partnership are also considered to be legally the same as the business, their personal assets are not protected from the debts and liabilities of the business.

Some common advantages of general partnerships include:

- Creation requires relatively little time and expense.
- There are typically few ongoing requirements.
- Many states do not impose a fee for the mere privilege of existing.
- There is no separate income tax filing for the company; income and losses are reported on the owners' personal tax returns.
- Partners have flexibility in establishing their responsibilities, such as capital contribution, management, etc.

Some common disadvantages of general partnerships include:

- The owners and the business are legally considered the same; therefore, partners are personally liable for the debts of the partnership.
- Partners are responsible for the business-related actions of all other partners.

C Corporation

The standard corporation, also called a C Corporation, is the most common corporate structure. To create a corporation, the proper formation documents, typically called the articles of incorporation or certificate of incorporation, must be filed with the appropriate state agency and the necessary state filing fees paid.

The corporation is a separate legal entity that is owned by shareholders. Because of this, the shareholders of a corporation typically cannot be held personally liable for the debts of the corporation. A shareholder's personal liability is typically limited only to the amount the shareholder invested in the company.

With corporations, taxation is one of the primary items often weighed. C corporations may experience double-taxation. The profits of the business are reported and first taxed at the entity level. If the corporation then distributes any portion of the remaining profit to the shareholders in the form of dividends, the shareholders must then report the dividend as personal income and pay taxes on it at the individual level. This creates the double taxation of the corporation's profits.

Some common advantages of a C corporation include:

- Shareholders are not typically personally liable for the debts of the corporation.
- C corporations can have an unlimited number of shareholders.
- The ownership of the corporation is easily transferable through the sale of stock.
- Corporations have unlimited life extending beyond the illness or death of owners.
- Certain business expenses are tax deductible.
- Additional capital can be easily raised through the sale of shares of the corporation's stock.



Some common disadvantages of a C corporation include:

- The possibility exists for double taxation of the corporation's profits.
- Corporations are more expensive to form than sole proprietorships and partnerships, and face ongoing filing requirements and state fees.
- Corporations face ongoing corporate formalities, such as holding and properly documenting annual meetings of directors and shareholders.

S Corporations

An S corporation is a standard corporation that has elected a special tax status with the Internal Revenue Service (IRS). The formation requirements for an S corporation are the same as those for C corporation wherein formation documents must be filed with the state and the appropriate state filing fees paid.

The S corporation's special tax status eliminates the possibility of the double-taxation that can occur with the C corporation. With S corporations, a corporation income tax return is filed, but no tax is paid at the corporate level. Instead, the profits of the corporation are "passed-through" to the shareholders and are reported on their individual tax returns. Tax is then only paid at the individual level.

As with C corporations, the shareholders of an S corporation are not typically held personally responsible for the debts and liabilities of the business.

Some common advantages of an S corporation include:

- S corporations avoid the possibility of double-taxation on the corporation's profits.
- Shareholders are typically not personally responsible for the debts and liabilities of the corporation.
- Most other advantages of the C corporation also apply to the S corporation.

Some disadvantages of an S corporation include:

- The IRS imposes restrictions on who can be a shareholder of an S corporation: shareholders must number fewer than 75; must be individuals, estates, or certain qualified trusts; and cannot be non-resident aliens.
- S corporations can have only one class of stock (disregarding voting rights).
- All shareholders of the corporation must consent in writing to the S corporation election.
- Corporations are more expensive to form than sole proprietorships and partnerships, and face ongoing filing requirements and state fees.
- Corporations face ongoing corporate formalities, such as holding and properly documenting annual meetings of directors and shareholders.

Limited Liability Company

The LLC is a distinct business entity that offers an alternative to partnerships and corporations by combining the corporate advantage of limited liability protection with pass-through taxation. To form an LLC, the appropriate formation documents, often called the articles of organization or certificate of organization, must be filed with the state and the appropriate state filing fees paid.

The LLC typically also experiences pass-through taxation. The LLC's income is not taxed at the entity level; however, the LLC does complete a tax return. The income or loss of the LLC as shown on this return is passed through the LLC and is reported on the owners' individual tax returns. Tax is then paid at the individual level.

As with corporations, the LLC is also legally considered to exist separately from its owners, which are called



members. Therefore, the members cannot typically be held personally responsible for the debts and liabilities of the LLC.

Some common advantages of LLCs include:

- LLCs have pass-through taxation.
- Members are not typically held personally responsible for the debts and liabilities of the LLC.
- LLCs typically have no restrictions on the number of owners (members) allowed.
- Members have flexibility in structuring the management of the company.
- The LLC does not require as much annual paperwork and have as many formalities as corporations and S corporations.

Some disadvantages of LLCs include:

- LLCs are more expensive to form than sole proprietorships and partnerships.
- Ownership is typically harder to transfer than with a corporation.
- The life of an LLC may be limited, as some states still require a dissolution date to be included in the formation documents.
- Because the LLC is a newer business structure, there is not as much case law to rely on for determining precedent.

Business Structure Comparison Chart

Characteristics	Sole Proprietorship	General Partnership	Limited Liability Company	S Corporation	C Corporation
Formation	No state filing required	Agreement between two or more parties. No state filing required.	State filing required	State filing required	State filing required
Duration	Dissolved if sole proprietor ceases doing business or dies	Dissolves upon death or withdrawal of a partner unless safeguards are in place in a partnership agreement	Dependent upon the requirements imposed by the state of formation	Perpetual	Perpetual
Liability	Sole proprietor has unlimited liability	Partners have unlimited liability	Members not typically personally liable for the debts of the LLC	Shareholders not typically personally liable for the debts of the corporation	Shareholders not typically personally liable for the debts of the corporation
Operational Requirements	Relatively few legal requirements	Relatively few legal requirements	Some formal requirements but less formal than corporations	Board of directors, officers, annual meetings, and annual reporting required	Board of directors, officers, annual meetings, and annual reporting required



Management	Sole proprietor has full control of management and operations	Typically each partner has an equal voice, unless otherwise arranged	Members have an operating agreement that outlines management	Managed by the directors, who are elected by the shareholders	Managed by the directors, who are elected by the shareholders
Taxation	Not a taxable entity. Sole proprietor pays all taxes.	Not a taxable entity. Each partner pays tax on his/her share of the income and can deduct losses against other sources of income	If structured for pass-through taxation, there is no tax at entity level. Income/loss is passed through to members.	No tax at the entity level. Income/loss is passed through to the shareholders.	Taxed at the entity level. Also, if dividends are distributed to shareholders, dividend income is taxed at the individual level.
Pass Through Income/Loss	Yes	Yes	Yes	Yes	No
Double Taxation	No	No	No	No	Yes, if income is distributed to shareholders in the form of dividends
Cost of Creation	None	None	State filing fee required	State filing fee required	State filing fee required
Raising Capital	Often difficult unless sole proprietor contributes funds	Contributions can be made from partners, and more partners can be added	Possible to sell interests, though subject to operating agreement restrictions	Shares of stock are sold to raise capital	Shares of stock are sold to raise capital
Transferability of Interest	No	No	Possibly, depending on restrictions outlined in the operating agreement	Yes, but must observe IRS regulations on who can own S corporation stock	Shares of stock are easily transferred

How Do You Incorporate a Business?

If you decide to form a corporation, LLC, nonprofit, or limited partnership you will need to file the necessary documents, often called the certificate or articles of incorporation for corporations or the certificate or articles of organization for LLCs, with the state in which you wish to form your business. All states impose state filing fees that must be paid to form your business there. These fees vary by state and entity type, but range from \$50 to over \$500.

Do It Yourself, Use an Incorporation Service Provider, or Use an Attorney?

Typically you have three primary options for incorporating your business. You can do it yourself, or use an incorporation service provider, or use an attorney or accountant.



If you choose to do it yourself, it would be beneficial to familiarize yourself with the requirements of your intended state of formation. You can often learn about a state's business formation requirements on the Secretary of State's website. You will then need to prepare the necessary documents and submit them to the state along with the required filing fees.

If you prefer to use an incorporation service provider, the provider will prepare and file the formation documents for you, and pay the necessary state filing fees. Reputable service providers will offer a breadth of information on their websites, allowing you the opportunity learn more about incorporating and the process itself. Also, many providers have a staff of knowledgeable customer service representatives with whom you can speak further to discuss any basic questions you may have about forming a business. One thing to remember is that these providers cannot provide legal or financial/tax advice, they can only provide general information to help you make an informed decision.

When placing an order, the provider will ask around 10 questions about you and your business that provide the necessary information required to complete the formation documents. With an incorporation service provider, you will typically pay a service fee plus the required state filing fees. Service fees often range from \$75 to \$175.

If you choose to use an accountant or attorney, you can seek advice that is specific to your particular business situation, such as learning which business structure best suits your overall business goals. Attorneys can often also provide customized documents for your company, such as bylaws, or even agreements that you would use in your business transactions. With an attorney or accountant, you will typically pay their hourly rate for the time spent on your incorporation, plus the state filing fees. Hourly rates vary by state and the accountant or attorney, but can often range from \$75 to over \$250 per hour.

One other item to consider is that if you use an incorporation service provider, attorney, or accountant, you can often enlist their services for other items that are complimentary to the formation. For example, incorporation service providers can often offer assistance with obtaining a federal tax identification number (also known as the employer identification number or EIN) for your business from the IRS, help with preparing the S corporation election form, and offer online tools to help your business comply with state-required corporate and LLC formalities.

How Long Does the Incorporation Process Take?

The time the state requires to approve and return your completed articles of incorporation or articles of organization varies by state. Often, it can take up to 4-6 weeks to become incorporated. Most states will allow you to expedite the filing process for an additional charge; expediting filings typically take about 1 week, and some states have 24-hour filing options for additional charges. Expediting charges also vary by state.

What Are the Next Steps After Incorporation?

In terms of ongoing requirements imposed on corporations and LLCs after the formation is complete, corporations have more strict obligations to follow. After a corporation is formed, an organizational meeting of directors must be held. At this meeting bylaws are adopted, stock is issued, and the incorporation process is completed. Minutes of the organizational meeting should be kept in a corporate record book. Corporations are also required to hold annual meetings of directors and annual meetings of shareholders. Not holding these meetings and keeping the proper records of them can have serious consequences for corporations.

For LLCs, the requirements are not as strict, but it is still advisable to hold an organizational meeting of the



members or managers after formation in order to adopt an operating agreement, and issue membership shares. It is also a good idea to hold regular meetings of the members or managers, to properly document major business decision, and to keep complete company records.

In addition to these formalities, keep in mind that the states impose annual requirements on all corporations and LLCs, such as filing an annual report. This report allows the state to keep updated information on corporations and LLCs formed or qualified to do business there. Each state's requirements for the report differ, as do the costs associated with them. Many states also impose annual franchise taxes on corporations and LLCs. It is recommended to research the annual requirements of the state in which you are evaluating incorporating your business, so that you know what to expect on an ongoing basis.

Summary

Once you decide to incorporate your business and decide which business structure your company will take, you will also need to consider in which state you wish to incorporate, who will hold the director and officer positions (if you are forming a corporation), or the member/manager and officer positions (if you are forming an LLC) in your company. These questions will all be typically be asked of you whether you form your own business with the state, use an incorporation service provider, or use an attorney. After you have incorporated, be sure to undertake the ongoing requirements for corporations and LLCs that were mentioned above.

While this process may seem a little unnerving right now, the truth is that the resources available today for small business owners and aspiring entrepreneurs have made the process of incorporating a business quite easy and affordable.



As a recipient of the QuickBooks New Business Starter Kit, you can receive \$30 off any corporation, LLC, or nonprofit formation order you place with Business Filings Incorporated. Since its inception in 1996, Business Filings has helped over 60,000 business owners with their formation needs. As this article outlined, you have a choice in how you incorporate your business, and Business Filings hopes to have the opportunity to assist you as well. To take advantage of this offer, please visit www.bizfilings.com/nbsk or call (800) 981-7183 and mention the QuickBooks New Business Starter Kit discount when ordering by phone.



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