

## **Entity Selection**

There are several entities you may use to structure your new business. Entity type and formation requirements may vary from state to state so it will be important for you to check with your state's Secretary of State to find out specifics about forming an entity in your state. Entity selection is very important and will impact your business and your personal life in a number of ways from taxation to insurance to liability protection. The information contained in this publication is informational only and should not be used in place of the advice of legal or taxation professionals. In the next several paragraphs we will take a brief look at several entities.

### **Sole Proprietorship**

A sole proprietorship is a business owned and operated by a single person. Sole Proprietorship is a simple and easy business structure that allows you to set up your business very inexpensively. This structure however does not provide the asset protection of a Limited Liability Company or Corporation. For the Sole Proprietor there is no separation of personal and business assets, as the individual is the business. This means that the business owner is also personally responsible for all debts and obligations associated with the business. This also means that the Sole Proprietor has none of the liability protection available to the owners of Limited Liability Companies or Corporations. A Sole Proprietorship may be desirable for individuals in fields that have low risk of injury, limited personal liability and limited business assets.

Some of the issues associated with running a Sole Proprietorship are the aforementioned liability issues, problems raising capital, as the ability of the business to raise capital is tied directly to the individual running the business. Sole Proprietorships are rarely attractive to investors because of the lack of personal liability protection that is available under other business structures. Other issues associated with being a Sole Proprietor may involve taxation issues associated with estimated quarterly tax payments and self-employment tax.

### **General Partnership**

A General Partnership, like a Sole Proprietorship is considered an "informal association" in most states. This means that there are limited filing requirements, and no liability protection for Partners. A General Partnership consists of two or more partners and should operate under a partnership agreement. This agreement spells out; how the business will operate, responsibilities of the partners, ownership interests, etc. If entering into a General Partnership you should understand that each partner is personally responsible for the debts and obligations of the Partnership and the partners do not enjoy the liability protection as they would through an LLC or Corporation.

### **Limited Partnership**

A Limited Partnership is a variation of the General Partnership. In a Limited Partnership, there is at least one General Partner and one Limited Partner. The General Partner is responsible for all of the debts and obligations of the business, while the liability of the Limited Partner is restricted to only the amount the Limited Partner invested. In a Partnership, the Partners income is reported as part of each Partner's personal income.

## Limited Liability Partnership

A Limited Liability Partnership is a General Partnership that chooses to operate as an LLP. This structure allows the members a greater degree of liability protection than a General Partnership and reduces their exposure to the debts and obligations of the Partnership. In an LLP Partners income is reported as part of each Partner's personal income.

## Limited Liability Company LLC

The Limited Liability Company is a relatively new business structure. There can be distinct advantages to operating as an LLC, especially if there are several individuals involved in the ownership of the business. The owners of an LLC are called "Members." There are two different types of limited liability companies, Single Member and Multiple Member. The first we will discuss and the simplest is the Single Member LLC. This is a structure in which there is only one member in the LLC. That member may be an individual or another entity. For tax purposes the Single Member LLC may be considered a "Disregarded Entity." This means that the business will not have to file a separate tax return; the "Single Member" may only be required to file Schedules C,E and F as part of their personal Federal Tax return. An LLC that has only one member may also be taxed as a Sole Proprietorship.

A Multiple Member LLC will have more than one member and those members need not be individuals. Those members may be other entities. Multiple member LLCs will be required to file a separate tax return as an independent entity. A Multiple Member LLC may also be the owner of a Single Member LLC.

There are several advantages to operating as a Limited Liability Company. One of the major advantages is that it can provide liability protection for the members. This protection may be in the form of personal protection from lawsuits, personal protection from the debts and debtors of the business and personal protection of the member's individual assets. Another advantage of an LLC is that income may be taxed as passive income, not as earned income, allowing the members to pay less tax on profits. Most of the disadvantages of an LLC revolve around the taxation and tax benefits of the managing member versus the passive members. I will not discuss these issues as they can be complex and are best left to be explained by an accountant or tax professional.

## Corporations

The two main types of corporations are S corporation and C corporations. I will not go into a discussion of either type of corporation at this time other than to say they can be more complicated when it comes to ownership structures and taxation. There are risks associated with double taxation so you will want to consult your attorney and your accountant if you're considering opening an S or C corporation. There are times when each may be appropriate, but those times would be very limited for the majority of the readership of this publication.