

How to Choose the Best Legal Structure for Your Business

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Choosing the right legal structure is a necessary part of running a business. Whether you're just starting out, or your business is growing, it's important to understand the options.

- Partnerships carry a dual status as a sole proprietorship or limited liability partnership, depending on the entity's funding and liability structure.
- Under an LLC, members are protected from personal liability for the debts of the business if it cannot be proven that they acted in an illegal, unethical or irresponsible manner in carrying out the activities of the business.
- Corporations can sell shares of stock to secure additional funding for growth, while sole proprietors can only obtain funds through their personal accounts, using their personal credit or taking on partners.
- This article is for business owners looking to learn more about the different small business legal structures.

Choosing the right legal structure for your business starts with analyzing your company's goals and considering local, state and federal laws. By defining your goals, you can pick the legal structure that best fits your company's culture. As your business grows, you can change your legal structure to meet your business's new needs.

We've compiled the most common types of business entities and their notable features to help you decide on the best legal structure for your business.

Types of business structures

The most common types of business entities include sole proprietorships, partnerships, limited liability companies, corporations and cooperatives. Here's more about each type of legal structure.

1. Sole proprietorship

This is the simplest form of business entity. With a sole proprietorship, one person is responsible for all a company's profits and debts.

"If you want to be your own boss and run a business from home without a physical storefront, a sole proprietorship allows you to be in complete control," said Deborah Sweeney, CEO of [MyCorporation](#). "This entity does not offer the separation or protection of personal and

professional assets, which could prove to become an issue later on as your business grows and more aspects hold you liable."

Proprietorship costs vary, depending on which market your business is part of. Generally, your early expenses will consist of state and federal fees, taxes, equipment needs, office space, banking fees, and any professional services your business decides to contract. Some examples of these businesses are freelance writers, tutors, bookkeepers, cleaning service providers and babysitters.

Here are some of the advantages of this business structure:

- **Easy setup.** A sole proprietorship is the simplest legal structure to set up. If your business is owned by you and only you, this might be the best structure for your business. There is very little paperwork since you have no partners or executive boards to answer to.
- **Low cost.** Costs vary depending on which state you live in, but, generally, the only fees associated with a proprietorship are license fees and business taxes.
- **Tax deduction.** Since you and your business are a single entity, you may be eligible for certain business tax deductions, such as a health insurance deduction.
- **Easy exit.** Forming the proprietorship is easy and so is exiting one. As a single owner, you can dissolve your business at any time with no formal paperwork required. For example, if you start a daycare center and wish to fold the business, you can simply refrain from operating the daycare and advertising your services.

Examples of sole proprietorships:

The sole proprietorship is one of the most common small business legal structures. Many popular companies started as sole proprietorships and eventually grew into multi-million dollar businesses. A [few examples](#) include:

- eBay
- JC Penny
- Walmart
- Marriott Hotels

2. Partnership

This entity is owned by two or more individuals. There are two types: a general partnership, where all is shared equally; and a limited partnership, where only one partner has control of its operation while the other person (or persons) contributes to and receives part of the profits. Partnerships carry a dual status as a sole proprietorship or limited liability partnership (LLP), depending on the entity's funding and liability structure.

"This entity is ideal for anyone who wants to go into business with a family member, friend or business partner, like running a restaurant or agency together," said Sweeney. "A partnership allows the partners to share profits and losses, and make decisions together within the

business structure. Remember that you will be held liable for the decisions made, as well as those actions made by your business partner."

The cost of a general partnership varies, but it is more expensive than a sole proprietorship, because you want [an attorney](#) to review your partnership agreement. The experience and location of the attorney can affect the price range. A general partnership must be a win-win for both sides for it to be successful.

An example of this type of business is Google. In 1995, co-founders Larry Page and Sergey Brin created a small search engine and turned it into the leading search engine globally. The co-founders first met at Stanford University while pursuing their doctorates and later left to develop a beta version of their search engine. Soon after, they [raised \\$1 million in funding](#) from investors, and Google began receiving thousands of visitors a day. Having a combined ownership of 16% of Google provides them with a total net worth of nearly \$46 billion.

Here are some of the advantages of this business structure:

- **Easy to form.** Like a sole proprietorship, there is little paperwork to file. If your state requires you to operate under a fictitious name ("doing business as" or DBA), you'll need to file a [Certificate of Conducting Business as Partners](#) and draft an [Articles of Partnership](#) agreement, both of which have additional fees. A business license is usually needed as well.
- **Growth potential.** You're more likely to obtain a business loan when there's more than one owner. Bankers can consider two credit lines rather than one, which can be useful if you have a less-than-stellar credit score.
- **Special taxation.** General partnerships must file [federal tax Form 1065](#) and state returns, but, usually, they do not pay income tax. Both partners report their shared income or loss on their individual income tax returns. For example, if you opened a bakery with a friend and structured the business as a general partnership, you and your friend are co-owners. Each owner brings a certain level of experience and working capital to the business, which can affect each partner's share of the business and their contribution. Let's say you brought the most seed capital for the business; it could be decided that you retain a higher share percentage, making you the majority owner.

Examples of partnerships

Next to a sole proprietorship, partnerships are one of the most common types of business structures. Examples of [successful partnerships](#) include:

- Warner Brothers
- Hewlett Packard
- Microsoft
- Apple
- Ben & Jerry's
- Twitter

3. Limited liability company

A limited liability company (LLC) is a hybrid structure that allows owners, partners or shareholders to limit their personal liabilities while enjoying the tax and flexibility benefits of a partnership. Under an LLC, members are shielded from personal liability for the debts of the business if it cannot be proven that they acted in an illegal, unethical or irresponsible manner in carrying out the activities of the business.

"Limited liability companies were created to provide business owners with the liability protection that corporations enjoy while allowing earnings and losses to pass through to the owners as income on their personal tax returns," said Brian Cairns, CEO of [ProStrategix Consulting](#). "LLCs can have one or more members, and profits and losses do not have to be divided equally among members."

The cost of forming an LLC comprises the state filing fee and can range from [\\$40 to \\$500](#), depending on the state you filed in. For example, if you file an LLC in the state of New York, there's a [\\$200 filing fee and \\$9 biennial fee](#). Further, you must file a [biennial statement](#) with the NY Department of State.

Although small businesses can be LLCs, some large businesses choose this legal structure. One example of an LLC is [Anheuser-Busch Companies](#), one of the leaders in the U.S. beer industry. Headquartered in St. Louis, Missouri, Anheuser-Busch is a wholly owned subsidiary of Anheuser-Busch InBev, a multinational brewing company based in Leuven, Belgium.

Examples of LLCs

The LLC is typical among accounting, tax and law firms, but other types of companies also file as LLCs. Well-known [examples include](#):

- Pepsi-Cola
- Sony
- Nike
- Hertz Rent-a-Car
- eBay
- IBM

4. Corporation

The law regards a corporation as an entity separate from its owners. It has its own legal rights, independent of its owners – it can sue, be sued, own and sell property, and sell the rights of ownership in the form of stocks. Corporation filing fees vary by state and fee category. For example, in New York, the S corporation and C corporation fees are [\\$130](#), while the nonprofit fee is \$75.

There are several types of corporations, including [C corporations](#), [S corporations](#), [B corporations](#), [closed corporations](#) and [nonprofit corporations](#).

- **C corporations**, owned by shareholders, are taxed as separate entities. [Morgan Chase & Co.](#) is a multinational investment bank and financial services holding company that's

listed as a C corporation. Since C corporations allow an unlimited number of investors, many larger companies, including Apple Inc., Bank of America, and Amazon, file for this tax status.

- **S corporations** were designed for small businesses and avoid double taxation, much like partnerships or LLCs. Owners also have limited liability protection. [Widgets Inc.](#) is an example of an S corporation that operates very simply: Employee salaries are subject to [FICA tax](#), while the distribution of additional profits from the S corporation does not incur further FICA tax liability.
- **B corporations**, otherwise known as benefit corporations, are for-profit entities structured to make a positive impact on society. [The Body Shop](#) has proven its long-term commitment to supporting environmental and social movements, resulting in an awarded B corporation status. The Body Shop uses its presence to advocate for permanent change on issues like human trafficking, domestic violence, climate change, deforestation and animal testing in the cosmetic industry.
- **Closed corporations**, typically run by a few shareholders, are not publicly traded and benefit from limited liability protection. Closed corporations, sometimes referred to as privately held companies, have more flexibility compared to publicly traded companies. [Hobby Lobby](#) is a closed corporation; it's a privately held, family-owned business. Stocks associated with Hobby Lobby are not publicly traded; rather, the stocks have been allocated to family members.
- **Open corporations** are available for trade on a public market. Many well-known companies, including Microsoft and Ford Motors, are open corporations. Each corporation has taken ownership of the company and allows anyone to invest.
- **Nonprofit corporations** exist to help others in some way and are rewarded by tax exemption. Some examples of nonprofits are the Salvation Army, American Heart Association and American Red Cross. These types of business structures have one sole purpose: focusing on something other than turning a profit.

Advantages of this business structure include :

- **Limited liability.** Stockholders are not personally liable for claims against your corporation; they are only liable for their personal investments.
- **Continuity.** Corporations are not affected by death or the transferring of shares by its owners. Your business continues to operate indefinitely, which is preferred by investors, creditors and consumers.
- **Capital.** It's much easier to raise large amounts of capital from multiple investors when your business is incorporated.

This type of business is ideal for businesses that are further along in their growth, rather than a startup based in a living room. For example, if you've started a shoe company and have already named your business, appointed directors, and raised capital through shareholders, the next step is to become incorporated. You're essentially conducting business at a riskier,

yet more lucrative rate. Additionally, your business could file as an S corporation for the tax benefits associated with it.

Examples of corporations

Once your business grows to a certain level, it's likely in your best interest to incorporate it. There are many popular [examples of corporations](#), including:

- General Motors
- Amazon
- Exxon Mobil
- Domino's Pizza
- P. Morgan Chase

5. Cooperative

A cooperative (co-op) is owned by the same people it serves. Its offerings benefit the company's members, also called user-owners, who vote on the organization's mission and direction and share profits. Advantages that cooperatives offer include:

- **Lower taxes.** Like an LLC, a cooperative doesn't tax its members on their income.
- **Increased funding.** Cooperatives may be eligible for federal grants that help them get started.
- **Discounts and better service.** Cooperatives can leverage their business size, thus obtaining discounts on products and services for their members.

[Forming a cooperative is complex](#) and requires you to choose a business name that indicates whether the co-op is a corporation, such as incorporated (Inc.) or limited. The filing fee associated with a co-op agreement varies by state. In New York, for example, the filing fee for an incorporated business \$125.

An example of a co-op is [CHS Inc.](#), a Fortune 100 business owned by U.S. agricultural cooperatives. As the nation's leading agribusiness cooperative, CHS recently reported a net income of [\\$829.9 million](#) for the fiscal year ending Aug. 31, 2019.

Examples of cooperatives

Unlike the other types of businesses, co-ops are owned by the people they serve. Notable [examples of co-ops](#) include:

- Land O'Lakes
- Navy Federal Credit Union
- Welch's
- REI
- Ace Hardware

Key takeaway: The five types of business structures are sole proprietorship, partnership, limited liability company, corporation and cooperative. Choosing the right structure depends largely on your business type. As your business grows, you'll be able to switch structures to meet its needs.

Factors to consider before choosing a business structure

For new businesses that could fall into two or more of these categories, it's not always easy to decide which structure to choose. You need to consider your startup's financial needs, risk and ability to grow. It can be difficult to switch your legal structure after you've registered your business, so give it careful analysis in the early stages of forming your business. **[Read related article: [Is It Too Late to Change Your Business Structure?](#)]**

Here are some important factors to consider as you choose the legal structure for your business. You should also plan to consult with your CPA for his or her advice.

Flexibility

Where is your company headed, and which type of legal structure allows for the growth you envision? Turn to your [business plan](#) to review your goals, and see which structure best aligns with those objectives. Your entity should support the possibility for growth and change, not hold it back from its potential.

Complexity

When it comes to startup and operational complexity, nothing is more simple than a sole proprietorship. You simply register your name, start doing business, report the profits, and pay taxes on it as personal income. However, it can be difficult to procure outside funding. Partnerships, on the other hand, require a signed agreement to define the roles and percentages of profits. Corporations and LLCs have various reporting requirements with state governments and the federal government.

Liability

A corporation carries the least amount of personal liability since the law holds that it is its own entity. This means that creditors and customers can sue the corporation, but they cannot gain access to any personal assets of the officers or shareholders. An LLC offers the same protection, but with the tax benefits of a sole proprietorship. Partnerships share the liability between the partners as defined by their partnership agreement.

Taxes

An owner of an LLC pays taxes just as a sole proprietor does: All profit is considered personal income and taxed accordingly at the end of the year.

"As a small business owner, you want to avoid double taxation in the early stages," said Jennifer Friedman, chief marketing expert at [Expertly.com](https://www.expertly.com). "The LLC structure prevents that and makes sure you're not taxed as a company but as an individual."

Individuals in a partnership also claim their share of the profits as personal income. Your accountant may suggest quarterly or biannual advance payments to minimize the end effect on your return.

A corporation files its own tax returns each year, paying taxes on profits after expenses, including payroll. If you pay yourself from the corporation, you will pay personal taxes, such as for Social Security and Medicare, on your personal return.

Control

If you want sole or primary control of the business and its activities, a sole proprietorship or an LLC might be the best choice for you. You can negotiate such control in a partnership agreement as well.

A corporation is constructed to have a board of directors that makes the major decisions that guide the company. A single person can control a corporation, especially at its inception, but as it grows, so, too, does the need to operate it as a board-directed entity. Even for a small corporation, the rules intended for larger organizations – such as keeping notes of every major decision that affects the company – still apply.

Capital investment

If you need to obtain outside funding, such as from an investor, venture capitalist, or bank, you may be better off establishing a corporation. Corporations have an easier time obtaining outside funding than sole proprietorships.

Corporations can sell shares of stock and secure additional funding for growth, while sole proprietors can only obtain funds through their personal accounts, using their personal credit or taking on partners. An LLC can face similar struggles, although, as its own entity, it is not always necessary for the owner to use their personal credit or assets.

Licenses, permits and regulations

In addition to legally registering your business entity, you may need specific licenses and permits to operate. Depending on the type of business and its activities, it may need to be licensed at the local, state and federal levels.

"States have different requirements for different business structures," Friedman said.

"Depending on where you set up, there could be different requirements at the municipal level as well. As you choose your structure, understand the state and industry you're in. It's not a 'one size fits all,' and businesses may not be aware of what's applicable to them."

The structures discussed here only apply to for-profit businesses. If you've done your research and you're still unsure which business structure is right for you, Friedman advises speaking with a specialist in business law.

Original Article: <https://www.businessnewsdaily.com/8163-choose-legal-business-structure.html>

For more information on business structures, visit the [U.S. Small Business Administration](#) website.

Key takeaway: Important factors to consider before liability, tax structure and industry regulations. By making a list of specific attributes about your business and its founders, you can choose the right business structure for you.

Additional reporting by Matt D'Angelo