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## Business Structures

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### Entity Concept

Every business stands separate and apart from its owner(s), even though the owner(s) has control of the assets, may have personal liability for debts and compliance, and receive income and accept losses.

### Sole Proprietorship

A sole proprietor, the simplest form of business, involves one individual (sometimes a married couple) conducting business. A small business often starts as sole proprietorship. Sole proprietors own the assets of the business and claim all profits generated by it. They also assume complete, unlimited responsibility for its liabilities. In the eyes of the law and the public, the owner is one and the same with the business (although the entity concept still applies).

#### Advantages of a Sole Proprietor

- Easiest and least expensive form of ownership structure to organize.
- Owner has complete control and may make decisions as sees fit.
- Owner receives all income generated by the business to keep or reinvest.
- Profits from the business flow directly to the owner's personal tax return.
- Easy to dissolve.

#### Disadvantages of a Sole Proprietor

- Owner has unlimited liability and complete responsibility for all debts of the business. All business and personal assets are at risk.
- Structure may be disadvantageous in raising funds. Proprietors are often limited to using funds from personal savings, consumer loans, or credit cards.
- Business may have a difficult time attracting high-performance employees or those motivated by the opportunity to own a part of the business.
- Certain employee benefits, e.g., owner's medical insurance premiums, are not directly deductible from business income.
- Life of proprietorship may be limited; should the proprietor pass, the business may terminate.

### Partnership

In a partnership, two or more individuals share ownership of a single business entity. Like proprietorships, the law does not distinguish between the business and its owners. The partners are considered joint and severally liable for obligations of the business. The partners should have a legal agreement setting forth decision making, profit-sharing, dispute resolution, admission of future partners to the partnership, buying out existing partners, and steps may be taken to dissolve the partnership.

Many partnerships split up in crisis, and unless the legal agreement specifies a defined process, problems may be magnified. Each such partnership agreement also will include how much time and capital each partner will contribute.

#### Advantages of a Partnership

- Partnerships are easily established; however, the partnership agreement is crucial.
  - With more than one owner, the ability to raise funds may be improved.
  - Profits from the business flow directly to the partners' personal tax returns.
  - Prospective employees may be attracted to the business if given incentive to become a partner.
  - The business often will benefit from partners who have complimentary skills.
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**Disadvantages of a Partnership**

- Partners are individually and jointly liable for debts and the actions of the other partners.
- Profits are shared with other partners.
- The decision-making process may be time consuming and disagreements can occur.
- Some employee benefits may not be tax-deductible.
- The partnership may have a limited life and may end with the withdrawal or death of a partner.

**Common Types of Partnerships:****1. General Partnership**

Partners divide responsibility for management, liabilities, and shares of profit or loss, according to the agreement. Equal shares are assumed unless a partnership agreement states differently.

**2. Limited Partnership**

This type has at least one general partner, with the usual partner responsibilities, and limited partners with liability limited to the extent of investment and restricted input regarding management decisions. This form often involves investors for short-term projects such as property development. Forming such a limited partnership is more complex and formal.

**3. Joint Venture**

This type of partnership usually forms for a limited time or a single project. If partners in a joint venture repeat the activity, it will be recognized as an ongoing partnership, will have to file as such, and will be required to follow requirements for a general partnership.

**4. Limited Liability Partnership**

This type of partnership is used for providers of specialized services, usually requiring a license, such as attorneys, accountants, or architects. A domestic limited liability partnership (LLP) requires an application for registration to the State Business Registry. Before such a partnership is filed, the name is checked for availability. The name must be distinguishable from other active names on the State Business Registry records. Also, the name of the LLP must contain the words "Limited Liability Partnership" or the abbreviation "L.L.P." or "LLP" as the last words or letters of its name. If the name is distinguishable and the application conforms to statute, the Business Registry returns an acknowledgement, usually a certificate of existence, to the LLP.

**Foreign Partnerships**

A foreign partnership, i.e., one domesticated (registered) in another State, must obtain authority from the State Business Registries to transact business in other States. A certificate of existence or similar document from the State of registration must be submitted with the application. Again, before the application is filed, the name is checked for availability. The name must be distinguishable from other active names. If the name is distinguishable and the application conforms to statute, the State Business Registry returns an acknowledgment to the partnership.

**Corporation**

A corporation, a "creature of the State" and not a "natural entity", is a legal entity created under State statute. Registration begins with submission of articles of incorporation (AOI) to the State Business Registry. The AOI states the entity name, its business purpose, the number of shares the corporation has authority to issue (although it seldom issues all shares), and the form of governance. Shareholders own the corporation, and shares sold and transferred are registered in the corporate records.

A corporation acts as a unique entity and exists separately from its owners. Although shareholders may change, the corporation continues to exist, effectively having perpetual life. As a separate entity, a corporation has similar rights to those of a natural entity – including, it may conduct business, own property, sue and be sued, and it's required to pay taxes at all levels.

The "incorporators" submit the AOI and the application for corporate status to the State of domestication. The AOI or Bylaws, depending on State requirements, indicate the number of Directors composing the Board of Directors. The Board provides governance and oversees the corporation. The Bylaws provide a high-level outline of the Company structure and how it operates. The Board elects Officers, including a President (the corporation's chief executive officer in the eyes of the State) and a Secretary (the corporation's chief records officer in the eyes of the State), who are responsible for company operations. The Board may elect or appoint other officers, and the Bylaws may prescribe how such officers are selected. Except for the initial board (the incorporators) or interim appointments, shareholders usually select the directors at an annual meeting.

A corporation must have a Registered Agent, an individual or legal entity, listed with the State of domestication. The Registered Agent accepts all legal papers on behalf of the corporation.

There are three common types of corporations: business corporations, professional corporations, and nonprofit (or not-for-profit) corporations. The first two operate as "for-profit" entities. A professional corporation, composed of licensed experts, renders services. The nonprofit corporation may be formed for any lawful purpose, does not have shareholders, usually has voting members without equity rights, and operates as a "mutual benefit society". The nonprofit usually focuses on an industry, professional, or social purpose, and generating profit is secondary to the benefits it provides.

Corporations formed under State statute are "domestic" corporations. Those formed under the laws of other states but transacting business in your State, are "foreign" corporations. Those formed outside of the United States are "alien" corporations.

### **Domestic Corporation**

To form a domestic corporation, AOI must be submitted to the State Business Registry. Once the State acknowledges the existence of the corporation, an organizational meeting of the Board of Directors is held to adopt Bylaws and elect Officers. The Bylaws may contain provisions necessary to regulate and manage the corporation's affairs consistent with State statutes and the AOI.

**"S" Corporation** – The State Business Registry does not have a separate filing for an "S corporation". This federal income tax designation may be granted by the IRS to any corporation meeting its requirements, including 100 or fewer shareholders, all individuals, no alien shareholders, and only one class of stock. "S" corporation status allows the corporation and its earnings to be taxed as a partnership, with the income tax obligation passed to the shareholders.

### **Foreign and Alien Corporations**

A foreign or alien corporation must obtain authority from the State Business Registry to transact business States other than that of domestication. An application of authority, including the name and address of its Registered Agent, must be submitted to the State Business Registry. A certificate of existence or similar document from the jurisdiction of incorporation must be submitted with the application form. Before an application of authority is filed, the name is checked for availability. The name must be distinguishable from other active names on file. If the name is distinguishable and the application conforms to statute, the Business Registry processes the document and returns an acknowledgment to the corporation.

### **Advantages of a Corporation**

- Perpetual life.
- Shareholders have limited liability for the corporation's debts and may only be held liable for their investment in stock of the company.  
Note: Directors and Officers may be held personally liable for illegal actions, for example, the failure to govern according to statute, failure to withhold and pay employment taxes, or the failure to deposit pension funds.
- A corporation may raise additional funds through the sale of unissued, authorized stock.
- A corporation may deduct the cost of benefits it provides to officers and employees.

**Disadvantages of a Corporation**

- The process of incorporation requires more time and funds than other forms of organization.
- Federal, state, and local agencies carefully monitor corporations with compliance filings.
- Incorporating may result in higher overall taxes. Dividends paid to shareholders are not deductible from business income; thus, earnings may be taxed twice, once at the corporate level and once at the shareholder level.

**Limited Liability Company (LLC)**

The LLC, a popular hybrid business structure for small entities, provides the limited liability features of a corporation and the tax efficiencies and operational flexibility of a partnership. Formation is more complex and formal than that of a general partnership.

Owners are referred to as "members". The duration of the LLC is usually determined before organization papers are filed. The time limit may be modified, if desired, by a vote of the members. LLC's must not have more than two of the four characteristics that define corporations: Limited liability to the extent of assets, continuity of life, centralization of management, and free transferability of ownership interest.

Taxed as a partnership in most cases, the LLC may be treated as a corporation for tax purposes if there are more than 2 of the 4 corporate characteristics, as described above.

**Assumed Business Name (ABN) Registration**

One of the primary reasons for registration of a business name involves telling the public who is doing business under that name, which also may be referred to as an "AKA" or "DBA" ("also known as" or "doing business as").

A business name must be registered with the State Business Registry as an ABN if the "real and true" name of each party who has an ownership interest in the business is not conspicuously disclosed to the public by the business name. Each person's "real and true" name includes first name, middle initial, and last name. A nickname is not a "real and true" name, and if used, it must be registered as an ABN. If words used suggest additional owners, such as "company" or "associates", the name must be registered.

A business name including the "real and true" names of all owners also may be registered, but such registration is optional. A corporation, LLC, LLP, or limited partnership does not need to register its name as an ABN, unless the entity wants to use the name without the entity type designation.

Companies may use certain tradenames or tradestyles, e.g., McDonald's, which is used by the McDonald Corporation. Such names, used primarily for marketing and promotional purposes, identify the company and may or may not be registered.

If a person transacts business as an unregistered ABN, he or she may not have standing in court to pursue or defend legal actions, and may be unable to transact regular business, e.g., obtaining licenses, opening bank accounts, entering into contracts.

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**\*Provided courtesy of NACM Commercial Services**