Forms of Business Ownership

As a business grows, its structural needs may change. Changing the structure of your business will have long-term implications, so consult with an accountant and attorney to help you select the form of ownership that is right for your company's evolving needs. In making a choice, you will want to take into account the following:

- 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 manage.
- The business's 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.

Here's an overview of the four basic legal forms of ownership for small businesses: sole proprietorships, partnerships, corporations, and limited liability companies (LLCs).

Sole Proprietorships

The vast majority of small businesses start out as sole proprietorships. These firms are owned by one person, usually the individual who has day-to-day responsibility for running the business. Sole proprietors own all the assets of the business and the profits generated by it. They also assume complete responsibility for any of its liabilities or debts. In the eyes of the law and the public, the owner *is* the business.

Partnerships

In a partnership, two or more people share ownership of a single business. Like proprietorships, the law does not distinguish between the business and its owners. The partners should have a legal agreement that sets forth how decisions will be made, profits will be shared, disputes will be resolved, how future partners will be admitted to the partnership, how partners can be bought out, or what steps will be taken to dissolve the partnership when needed. Yes, it's hard to think about a "break-up" when the business is just getting started, but many partnerships split up at times of crisis, and unless there is a defined process, there will be even greater problems. They also must decide up-front how much time and capital each will contribute, etc.

Corporations

A corporation—chartered by the state in which it is headquartered—is considered by law to be a unique entity, separate and apart from those who own it. A corporation can be taxed; it can be sued; it can enter into contractual agreements. The owners of a corporation are its shareholders. The shareholders elect a board of directors to oversee the major policies and decisions. The corporation has a life of its own and does not dissolve when ownership changes.

Subchapter S Corporations

A tax election only, this form of ownership enables the shareholder to treat the earnings and profits as distributions, and have them pass through directly to their personal tax return. The catch here is that the shareholder, if working for the company, must pay herself wages if there is a profit, and those wages must meet standards of "reasonable compensation." This can vary by geographical region, as well as occupation, but the basic rule is to pay yourself what you would have to pay someone to do your job, as long as there is enough profit. If you do not do this, the IRS can reclassify all of the earnings and profit as wages, and you will be liable for all of the payroll taxes on the total amount.

Limited Liability Companies (LLCs)

The LLC is a relatively new type of hybrid business structure that is now permissible in most states. It is designed to provide 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.

The owners are members, and the duration of the LLC is usually determined when the organization papers are filed. The time limit can be continued, if desired, by a vote of the members at the time of expiration. LLCs 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 interests.

There are many options available to today's business owner, but determining the appropriate form of business ownership can be complicated. As such, a legal professional should be consulted.

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