

WHAT FACTORS SHOULD BE CONSIDERED IN CHOOSING THE TYPE OF BUSINESS ENTITY FOR MY BUSINESS?

There Are Myriad Organizational Structures and Choosing the Correct One for Your Company Is Essential to Achieve Your Business Plan Goals and to Minimize Risks

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The formation of a business requires an understanding of your goals for future operations so you can determine the appropriate business structure to operate under. There are myriad organizational structures and choosing the correct one for your company is essential to

achieve your business plan goals and to minimize risks.

An experience attorney should be consulted during the process of business formation to ensure that the correct choice is made. A business law attorney can explain the advantages and disadvantages associated with each type of business entity so that the best choice is made.

FACTORS TO CONSIDER IN CHOOSING THE TYPE OF BUSINESS ENTITY TO OPERATE

Factors to consider in choosing the type of business entity to operate include:

- The number of owners and stakeholders in the business
- Whether your organization will be operating in a for-profit capacity or as a non-profit organization
- The complexity of initial and annual paperwork requirements
- The desired tax structure
- A future intention to take your business public or to sell your business
- Liability protection

THE NUMBER OF OWNERS AND STAKEHOLDERS

Individuals operating a business as the single owner could operate as a sole proprietorship. This is the simplest business structure that requires no additional formalities for forming the business. However, a sole proprietorship is possible only if there are no other owners and only if the owner is willing to assume personal liability for debts and risks the business takes on.

Whenever multiple parties wish to share ownership of a business, a more formal legal structure becomes necessary. There are myriad options for shared ownership including:

- Partnership
- Limited Liability Companies (LLCs)
- Limited Liability Partnerships (LLPs)
- S-Corporations
- C-Corporations

C-corporations are the most complex form of business organization to form, but allow for hundreds or even thousands of stakeholders to have an ownership interest in the business. Owners are protected when buying an interest in C-corp and can lose only their initial investment in most cases. Transferring an ownership interest is also the simplest for businesses organized as C-corporations.



Partnerships, LLCs and LLPs and S-corporations also allow for shared ownership, with varying degrees of liability protection. There are restrictions on who may take an ownership share in these types of corporations and an attorney should be consulted to determine which is the right option for you.

WHETHER YOUR ORGANIZATION WILL BE OPERATING FOR PROFIT

Non-profit organizations must be granted special tax-exempt status from the Internal Revenue Service (IRS) and must have a legitimate purpose for their organization to provide services to the public. Charitable and arts organizations routinely operate as nonprofit organizations.

Articles of incorporation must be filed for the nonprofit, followed by applying for tax-exempt status with the IRS and registering as a nonprofit in the state where you will be doing business.

THE COMPLEXITY OF INITIAL AND ANNUAL PAPERWORK REQUIREMENTS

All businesses other than sole proprietorships will require legal documentation and paperwork to begin operations. Partnerships, for example, will require an operating agreement as well as registration of the partnership with the state.

Both S-corporations and C-corporations have the most complex paperwork requirements. In addition to filing initial Articles of Incorporation, the corporation will also have annual filing requirements. Corporations are considered separate legal entities and must file separate business tax returns. Speak with your attorney about the requirements of completing corporate forms and filing requirements in the state where your corporation will be formed.

THE DESIRED TAX STRUCTURE

Most types of business entities allow for the income and losses to pass through to the owners of the business, rather than the business being taxed separately. For example, both partnerships and S-corporations allow for pass-through taxation. C-corporations, on the other hand, require the business to pay taxes on income at corporate rates. When dividends are issued to owners, the income is then taxed again. As a result, C-corporations can sometimes create problems

of double taxation. These problems may be avoidable, or may be a necessary tradeoff for the benefits of operating as a C-corporation. This depends upon the other needs of your company.

A FUTURE INTENTION TO TAKE YOUR BUSINESS PUBLIC

Most businesses are privately owned by a small circle of individuals. Even S-corporations generally have a limited number of shareholders who hold an ownership interest. LLCs, partnerships and S-corporations can be difficult to value and difficult to sell.

Some companies, however, are publicly traded. This means that shares of the company can be sold. The companies traded on the New York Stock Exchange (NYSE) are publicly traded companies.

Those who intend to take their companies public or who wish to ensure that the easy sale of their business can be facilitated in the future may wish to consider forming a corporation. However, with the help of an attorney, virtually all businesses could be taken public if the company is profitable or desirable enough to make the process viable.

LIABILITY PROTECTION

A business may incur debts and may be sued for employment law issues or product defects, among other things. If a company is operated as a sole proprietorship or as a partnership, the owners of the business are generally



going to be personally liable for debts and for company liability. This means that the owners of the business could have their own personal assets at risk.

A C-corporation and an S-corporation create a separate legal identity for the business. The business is its own “person,”

and owners are generally not personally liable for the acts of the business unless they co-sign loan guarantees or if they act improperly and fail to maintain corporate formalities.

Liability protection is one of the most important considerations in business formation and it is essential to work with an attorney to develop appropriate liability protections to avoid jeopardizing personal assets.

About the Author

Lotzar Law Firm, P.C. was founded in 2005, and serves clients throughout the U.S. We pride ourselves on the level of service we provide our clients and are determined to see each project through to positive results.

In addition to bringing a legal expertise to the table, we offer clients sound ideas and invaluable advice that enhances their business. One of our greatest attributes is our ability to approach projects from a business-owner perspective. Rather than narrowing in on the setbacks of a challenge and informing clients of what stands in the way, we prefer to seek innovative ways to transcend issues and create a better path for clients. With an unparalleled savvy in developing modern methods of financing, we can present you with viable and efficient options.

Our diversified portfolio of clients is comprised of entrepreneurs, real estate developers, contractors and property managers. We also do business with numerous nonprofit clients including Chicanos Por La Causa, Inc.; Tiempo, Inc.; and The Industrial Development Authority of the City of Tucson, Arizona.

We work in a team-based environment, supported by a skilled and caring staff, eager to answer your questions and provide you with consistent access to your team. Whether your needs are small or large in scope, we look forward to working with you.

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