

CHOOSING THE RIGHT TYPE OF BUSINESS ORGANIZATION IN ARIZONA

*The Selection of an Appropriate
Business*

*Organization can Impact Liability,
Taxes, Owner's Rights and Future
Ability to Sell an Ownership Interest*



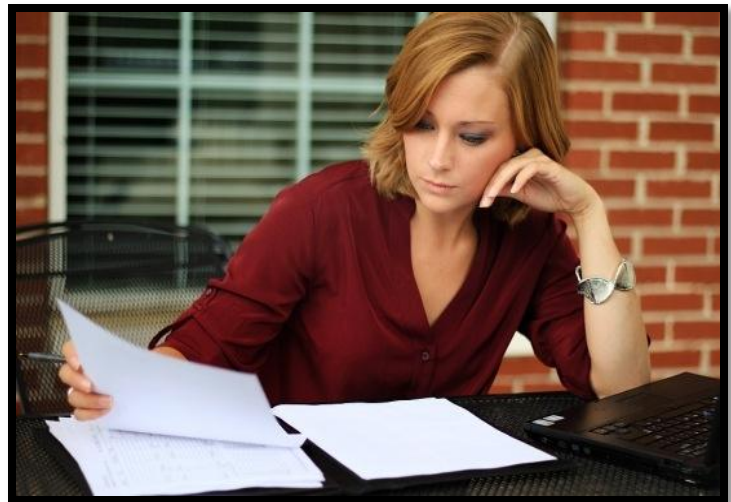


Selecting the right type of business organization is essential when starting or growing a company. The selection of an appropriate business organization can impact liability, taxes, owner's rights, and future ability to sell an ownership interest.

An experienced business law attorney can assist you in understanding the different types of business organizations and in choosing the correct type for your company. Always consult with a legal professional when making important business choices so you can take advantage of legal protections that are available.

There are many types of business organizations including sole proprietorships, s-corporations, c-corporations, professional corporations, limited liability companies, general partnerships and limited liability partnerships. In general, however, the different types of organizations can be broadly divided into four different categories: sole proprietorships; partnerships, limited liability companies and corporations.

Sole proprietorships are the most common type of business organization in the United States. A sole proprietorship involves one owner of a company conducting business. The organization may have employees but has only a single owner.



Starting a sole proprietorship is very simple. After securing appropriate professional and business licenses, there are no additional requirements to begin operation. An individual can create a sole proprietorship simply by starting to do consulting work or by offering a product or a service. The sole proprietor declares business income and business losses on his personal tax return and can dissolve the business at any time simply by discontinuing the work being performed or the product or service being offered.

Benefits of a sole proprietorship include:

- Ease of startup and dissolution.
- Low operational overhead costs.
- Full ownership of all profits.
- Few regulations.
- No requirement to file a corporate income tax return or pay corporate taxes.

Disadvantages include:

- Unlimited owner liability. Owners are personally responsible for debts and personal assets are at risk.
- Limited operational life. Generally, when the owner of a sole proprietorship dies, the business does not continue to operate.
- Difficulty raising capital. Options for funding may be limited to personal loans or savings.

Partnerships are similar in important ways to sole proprietorships, with the primary difference being that partnerships allow multiple individuals to operate a business as co-owners. Partnerships may be small businesses started by a few friends or co-workers, or may be large organizations such as law firms or accounting firms with dozens or hundreds of partners. Partnerships have advantages including:

- Ease of startup and dissolution. While partners should create a comprehensive partnership agreement, there are few legal requirements to begin operation.
- Fewer regulations compared with a corporation.
- No requirement to file a corporate tax return or pay corporate taxes. Profits and losses are passed through to owners who take a pro-rata share.
- Potentially broader access to capital. Partnerships may be more easily able to borrow money than sole proprietorships.

Disadvantages of a partnership include:

- Unlimited owner liability. While special limited liability partnerships can sometimes shield certain owners from liability, general partnerships provide no protection. Each partner is legally responsible for debts and judgments against the business.
- Limited life. A partnership frequently ends if partners leave or die.

Corporations provide much more protection for business owners than partnerships or sole proprietorships do. Corporations create a separate legal identity for the company. The business exists independently of the owners. Owners own shares in the organization and the owner's liability is limited to the investment made in the company. The owners are protected from liability unless they sign personal guarantees, and the owner's personal assets cannot be taken to pay a judgment against the corporation or to satisfy business debts.

Benefits of a corporation include:

- Unlimited life. The corporation can continue to exist even if it changes hands or if an owner dies.
- Greater flexibility in raising funding for operational costs. Capital can be raised by selling stock.
- Limited liability.

Disadvantages of a corporation include:

- Higher startup and ongoing costs. Articles of Incorporation must be filed with the state and fees must be paid both when the organization is started and each year thereafter while the business remains in operation.
- More regulations than sole proprietorships or partnerships. Corporations may have to comply with more local, state and federal laws than other types of business organizations.

Corporations can take two primary forms: S-corporations and C-corporations. S-corporations allow for pass-through taxation so owners declare profits and losses on personal tax returns. C-corporations are taxed on corporate profits and owners are also taxed on distributions. This creates the potential for double taxation of business profits.

Finally, Limited Liability Companies (LLCs) are the last major type of business structure. LLCs provide the liability protections of a corporation, but the flexibility in operations and the tax efficiencies of partnerships.

LLC owners are called “members,” and individuals, corporations and even other LLCs can all have an ownership interest. Formation of an LLC can be more complex than a partnership or sole proprietorship since you need to file Articles of Organization as well as creating an operating agreement. You’ll also need to elect how you want your organization to be taxed by filing Form 8832 with the IRS. However, it is usually less paper-work intensive to start an LLC than to start an S-corp.

Benefits of an LLC include:

- Liability protections for owners.
- Less paperwork than an S-corporation and lower start-up costs than forming a corporation.
- Fewer restrictions on how profits are shared among owners when compared with an S-corp.

Disadvantages include:

- A limited life. An LLC is dissolved in most states when a member leaves. Remaining members will need to form a new LLC if they want to continue to operate.
- Owners are responsible for self-employment taxes. Members are considered self-employed and the entire net income of the LLC is subject to Medicare

and Social Security taxes. S-corps allow owners to shield some of their income from these taxes if the income is paid out as distributions.

Choosing the correct type of business organization is complicated because of the fundamental differences between different organizational structures. To select the right type of business organization, you should consult with an experienced Scottsdale, AZ business lawyer who can review the characteristics of your organization and advise you on the best business structure.



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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