

Deciding On A Business Type

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So you have a great business idea. Now it's time to form the company. Partnership? LLC? S-corp? C-corp?

There are three basic entity types: partnerships, limited liability companies, and corporations.

Partnerships can be either general partnerships or limited partnerships. A general partnership is an informal association of one or more partners. Each partner has unlimited personal liability for the debts and expenses of the company. A limited partnership is a formal association of partners. The limited partners are not actively involved in the company and are not personally liable for the debts of the company. The general partners manage the affairs of the company and have unlimited personal liability for the debts and expenses of the company. The partnership does not pay taxes on its income; rather, the items of income and expense flow down to the partners.

Limited liability companies (LLCs) have generally replaced limited partnerships. In LLCs, all owners are not personally liable for the debts of the company. The owners are called "members." The LLC is managed by "managers" who may or may not be owners of the LLC. The Internal Revenue Service allows LLCs to choose to either be taxed as a partnership or as a corporation.

Corporations are formal legal entities. Corporations must follow certain formalities in order for the owners to not be personally liable for the debts of the corporation. The owners are called "shareholders." The day to day operations of the corporation are handled by the "officers" who act under the direction of the "directors." Typically corporations are subject to double taxation, meaning that the corporation pays taxes on its income and then the shareholders pay taxes on the dividends. If certain restrictions are met, a corporation can elect to be taxed as an "s-corporation." Generally s-corporations are subject to a single level of taxes, divided between income and dividends.