Types of Businesses

The following contains the six major types of businesses in America today. Each have their own unique advantages and disadvantages, indicated in the tables.

1. Sole Proprietorship

This is the simplest and most widely used structure for business. It is the least-regulated type of the various business structures. For tax and legal purposes, the owner is the business. The unlimited liability factor is the greatest disadvantage. The liabilities of the business are personal to the owner and the business ceases to exist when the owner retires or dies.

Advantages	Disadvantages
• Sole owner has total control over the operation of his/her business. • The least regulated form of business. • Other than records for tax purposes, there are few legal requirements as to how the business must operate. • Usually one only needs to obtain a license or pay a fee to a local registering authority.	• All of the personal and business assets of the sole owner are at risk in the sole proprietorship. • A judgement against the sole proprietorship could take the personal assets of the sole owner such as your house or a lien on your bank accounts. • Due to the structure, it may be difficult to take out a loan. If there is insufficient collateral, a sole proprietor may have to mortgage, second-mortgage a loan or place another piece of personal property as collateral. • When the sole owner dies or retires, the business often ceases to exist due to the lack of structure in this business type. • There is little or no vacation time for a sole proprietor.

2. General Partnership

This type of business only requires a general agreement of the parties involved in the business venture. There is usually no official government permission required. It does differ from the Sole Proprietorship in the table below.

Advantages	Disadvantages
• Relatively few legal requirements. • Partners have unlimited liability. • Typically each partner has an equal voice unless otherwise arranged. • Each partner pays tax on his/her share of the income and can deduct losses against other sources of income. • Raising capital is somewhat easier as it comes from contributions from the original partners or additional partners if the business grows.	• It is easily dissolved by the death of a partner or by bankruptcy. • Sometimes the partners disagree as to how the business is to be run or one partner does more work than the other causing the business to close.

3. Limited Partnership (LP)

The Limited Partnership is a hybrid type of business structure. It contains elements of both a traditional partnership and a corporation. It may be used when some interested parties want to invest in a partnership but only want limited liability and do not wish to exercise any control over the business activities of the partnership, i.e. a “Silent Partner.” The Limited Partnership is subject to more regulations on the state level, covered in the Uniform Limited Partnership Act. The General Partner runs the business day-to-day and is the risk taker for the conduct of the partnership while the Limited Partner risks only the money he has invested.

Advantages	Disadvantages
• The Limited Partner, as long as he/she remains passive, has no personal liability and risks only what they invest into the business. • The low risk for the Limited Partner and the fact that the Limited Partner shares in the profits and has tax deductions with no duties regarding the active control of the business, may make it easier for the partnership to find investors.	• There is always a chance for a lack of continuity and clear-cut guidelines amongst the partners concerning who does what and how to conduct the business. • Due to state regulations, Limited Partnerships are subject to more paperwork than a General Partnership. • General partners maintain full personal risk. The Limited Partner risks losing the benefits of the Limited Partnership if they take an active role in the day-to-day operations of the business.

4. Limited Liability Company (LLC)

For many small business owners, a **Limited Liability Company** (**LLC**) offers advantages over a “C” corporation (also known as a "general" corporation). Creating an **LLC** combines the tax advantages of a sole proprietorship or partnership with the liability protection of a corporation. A limited liability company (LLC) combines elements of a partnership, sole proprietorship and a corporation.

Advantages	Disadvantages
• LLCs provide limited liability protection to their owners (members), who are typically not personally responsible for the business debts and liabilities of the **LLC**. • Creditors cannot pursue the personal assets (house, savings accounts, etc.) of the owners to pay business debts. • Several formal requirements are needed but less formal than corporations. • Members have operating agreements that outline the management of the business. • Id properly structured, there is no tax at the entity level. Income/Loss is passed through to members of the LLC. • It is possible to sell interests in a LLC.	• Compared to a sole proprietorship or partnership, an **LLC** is a little more expensive to operate. • Selling interest in a LLC is subject to operating agreement restrictions. • State permission is required for formation. • A LLC is typically limited to a fixed amount of time. • A limited liability company owner may have to pay unemployment compensation for him or herself, which he or she would not have to pay as a sole proprietor. • Checks made out to a limited liability company cannot be cashed; they must be deposited into a corporate account. Some banks have higher fees just for businesses that are incorporated. • The owners of a limited liability company must be careful to keep their personal business separate from the business of the limited liability company. The limited liability company must have its own records and should have minutes of meetings.

5. The Corporation – the "C" Corporation

A corporation is created by filing Articles of Incorporation with the state and this allows a corporation the legal right to conduct business within that particular state. Corporations are more complex than either a LLC, partnership, sole proprietorship and are subject to more regulation by the state.

The internal rules of a corporation that outline the operation and management are called the **by-laws**.

Corporate Structure – A concise explanation of the purpose of the company.

Shareholders – They own a share of the business but do not engage in the direct management of the operation except by electing the directors of a corporation and by voting on major corporate issues.

Directors – They may be shareholders but they do not own any of the business. As a group known as the Board of Directors, they are jointly responsible for making the major business decisions for the corporations as well as appointing officers of the corporation.

Officers – They may be shareholders and/or directors, but, they do not own any of the business. They are responsible for the day-to-day operations. They are usually called under the titles of President, Vice-President, Secretary or Treasurer.

Advantages	Disadvantages
• Potential for limited liability is one of the most important advantages. • The liability of corporate debt is usually limited to the amount of money each investor has invested. • Theoretically, a corporation can exist forever. • A shareholder can freely sell, trade, or give-away his stock unless this right is formally restricted by corporate decision. • Taxation laws are often in favor of a corporation. • A corporation can sell shares of stock to raise more capital if needed.	• A certain degree of individual control or personal attention is often lost within a corporation. • There are strict formalities that have to be followed with many legal requirements, both state and federal. • The initial state filing fees can be excessive. • Profits are subject to double taxation when distributed to shareholders in the form of dividends. • Corporate losses cannot be deducted by a shareholder.

6. The “S” Corporation

Corporations can elect "pass-through" taxation by applying to the IRS for status as a Subchapter “**S” Corporation**. The “**S” Corporation** provides the same protection from personal liability as a regular “**C” corporation**. However, owners of an “**S” Corporation** can report their share of profit and loss in the company on their individual tax returns.

Advantages	Disadvantages
• An “S” corporation shareholder’s personal assets, such as personal bank accounts, cannot be seized to satisfy business liabilities. • A shareholder is not personally responsible for the business debts and liabilities of the corporation. • Creditors cannot pursue the personal assets (house, bank accounts, etc.) of the shareholders to pay business debts. • An “S” corporation does not pay federal taxes at the corporate level. (Most—but not all—states follow the federal rules. • Any business income or loss is "passed through" to shareholders who report it on their personal income tax returns. This means that business losses can offset other income on the shareholders’ tax returns. This can be extremely helpful in the startup phase of a new business. • An “S” Corporation can sell shares of sock to raise capital is needed.	• To operate as an “S” corporation, it is necessary to first incorporate the business by filing Articles of Incorporation. • Many states also impose ongoing fees, such as annual report and/or franchise tax fees. Although these fees usually are not expensive, and can be deducted as a cost of doing business, they are expenses that a sole proprietor or general partnership will not incur. • An “S” corporation can have only one class of stock, although it can have both voting and non-voting shares. Therefore, there can’t be different classes of investors who are entitled to different dividends or distribution rights. • There cannot be more than 100 shareholders. Foreign ownership is prohibited, as is ownership by certain types of trusts and other entities. • Because amounts distributed to a shareholder can be dividends or salary, the IRS scrutinizes payments to make sure the characterization conforms to reality.

Name: ____

<u>From the above handout and your own research, complete the following questions.</u>

1. Identify and name what you think are two different Sole Proprietorships.

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2. Identify and name what you think are two different General Partnership businesses.

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3. What other benefit can you think of by being the owner of a Limited Partnership (LP)?

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4. According to the table, there are more disadvantages than advantages of a Limited Liability Company (LLC). In your opinion, why then do you think that this type of business is growing rapidly?

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5. Search Google Images for examples of “C” Corporations. Did you find any familiar names, if so, name three of these companies?

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6. Why do you think that the government does not allow foreign ownership of an “S” Corporation?

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