

Compare Entities and Choose a Business Form

Sole Proprietorships

- Most common form of business ownership
- Owned by one person, who owns all the assets of the business and the profits generated by it
- Owner has unlimited liability and is legally responsible for all debts against the business.
- Easiest and least expensive form of ownership to start or dissolve
- Owner is in complete control of management and receives all income generated by the business
- Owner contributes the capital and may be limited to using funds from personal savings or consumer loans to raise capital
Some employee benefits such as owner's medical insurance premiums may be only partially deductible as an adjustment to income.

Key Documents for Setup

DBA filing or Fictitious Name Registration.

EIN registration

Taxation

The entity is not taxed. Profits from the business flow directly to the owner's personal tax return.

Typical IRS Forms required

Form 1040: Individual Income Tax Return

Schedule C: Profit or Loss from Business

Schedule SE: Self-Employment Tax

Form 1040-ES: Estimated Tax for Individuals

Form 4562: Depreciation and Amortization

Form 8829: Expenses for Business Use of your Home

Employment Tax Forms

Corporation

- Unlimited number of shareholders allowed with no limit on stock classes.
- Shareholders generally have no personal liability for the obligations of the corporation. However, the officers of the corporation can be held personally liable for their actions.
- A Board of Directors provides the overall management with officers handling day to day management.
- Corporations can raise additional funds through the sale of stock.
- Corporate Tax rates may be lower than the individual taxpayer's rate.
- A corporation may deduct the cost of benefits (ex: Health and Life Insurance) it provides to officers and employees.
- Can elect S corporation status
- Corporations are monitored by federal, state and some local agencies which may require stricter compliance.

Key Documents for Setup

Articles of Incorporation, Bylaws

Board Resolutions

Stock Certificates and Stock Ledger

Taxation

The Corporation is taxed on its income and the shareholders pay taxes on the dividends – double taxation.

Shareholders cannot deduct the losses of the corporation.

Typical IRS Forms required

- Federal Tax Forms for Regular or "C" Corporations
- Form 1120 or 1120-A: Corporation Income Tax Return
- Form 1120-W Estimated Tax for Corporation
- Form 8109-B Deposit Coupon
- Form 4625 Depreciation
- Employment Tax Forms
- Other forms as needed for capital gains, sale of assets, alternative minimum tax, etc.

S Corporations

- The same as the C Corporation in terms of management and the liability of shareholders.
- The primary difference is the tax election which enables the shareholder to treat the profits of the corporation as distributions and have them pass through directly to their personal tax return.
- Up to 100 shareholders allowed and only one basic class of stock allowed
- If the corporation does show a profit, the shareholder, if working for the company, must be paid wages, which must meet standards of "reasonable compensation".

Key Documents for Setup

- The same as needed for the C Corporation with the addition of:
IRS & State S Corporation Election

Typical IRS Forms required

- Form 1120S: Income Tax Return for S Corporation
- 1120S K-1: Shareholder's Share of Income, Credit, Deductions
- Form 4562 Depreciation
- Employment Tax Forms
- Form 1040: Individual Income Tax Return
- Schedule E: Supplemental Income and Loss
- Schedule SE: Self-Employment Tax
- Form 1040-ES: Estimated Tax for Individuals
- Other forms as needed for capital gains, sale of assets, alternative minimum tax, etc.

Partnerships

- Partnerships are relatively easy to establish
- With more than one owner, the ability to raise funds may be increased.
- Prospective employees or investors may be attracted to the business if given the incentive to become a partner.
- The business usually will benefit from partners who have complementary skills.
- Partners are jointly and individually liable for the actions of the other partners. For example, if one partner took out a loan against the business or property — the other partner(s) would be jointly liable for the repayment of that loan.

General Partnerships

- Partners divide responsibility for management and liability as well as the shares of profit or loss according to their internal agreement
- Equal shares are assumed unless there is a written agreement that states differently.

Limited Partnership and Partnership with limited liability

- Limited means that most of the partners have limited liability (to the extent of their investment)
- Partners have limited control over management decisions
- Typically used by investors for short-term projects or for investing in capital assets.
- Generally not the best structure for operating retail or service businesses.
- Since decisions are shared, disagreements can occur.
- Some employee benefits are not deductible from business income on tax returns.
- The partnership may have a limited life, for example the partnership could be dissolved upon the withdrawal or death of a partner.

Key Documents for Setup

General Partnership

- General Partnership Agreement
- Public Record Filing if the partnership involves Real Estate

Limited Partnership

- Limited Partnership Certificate
- Limited Partnership Agreement

Taxation

The entity is not taxed. The profits and losses are passed to the individual partners.

Typical IRS Forms required

- Form 1065: Partnership Return of Income
- Form 1065 K-1: Partner's Share of Income, Credit, Deductions
- Form 4562: Depreciation
- Form 1040: Individual Income Tax Return
- Schedule E: Supplemental Income and Loss
- Schedule SE: Self-Employment Tax
- Form 1040-ES: Estimated Tax for Individuals
- Employment Tax Forms

Limited Liability Company (LLC)

- o Designed to provide the limited liability features of a corporation and the tax advantages and operational flexibility of a partnership
- o The owners are called members
- o A time limit is set for the LLC to exist which can be continued, by a vote of the members.
- o Active members are subject to self employment tax for Social Security and Medicare
- o LLCs cannot have more than two of the four characteristics that define corporations:
 1. Limited liability to the extent of assets
 2. Continuity of life
 3. Centralization of management
 4. Free transferability of ownership interests.

Key Documents for Setup

- Articles Of Organization
- Operating Agreement

Taxation

The entity is not taxed (unless it chooses to be). Profits and losses are passed to the individual partners.

Typical IRS Forms required

- Form 1065: Partnership Return of Income
 - Form 1065 K-1: Partner's Share of Income, Credit, Deductions
 - Form 4562: Depreciation
 - Form 1040: Individual Income Tax Return
 - Schedule E: Supplemental Income and Loss
 - Schedule SE: Self-Employment Tax
 - Form 1040-ES: Estimated Tax for Individuals
 - Employment Tax Forms
- Corporation forms must be used if there are more than 2 of the 4 corporate characteristics