

What are my Choices for a Business Entity? What does it Mean for a Business to be a Person?

While you can start selling products and/or services right now and that would be a business you would not have a separate legal entity from yourself. You would be a sole proprietorship. If you started selling products and/or services with someone else, then you would have a partnership. However, for most businesses nowadays there are really only two types of business entities. Either a **Corporation** or a **Limited Liability Company**. While, there are indeed other types of business arrangements these two type of legal entities are really the only choice for conducting business in the modern world. Let's now focus on the concept of **separate legal entity**. You are a natural, living, breathing person. As a person you have certain legal rights. One of these rights is the ability to sue others and be sued for your actions. Another right is to own property. In the US legal system we have created a legal fiction that states that certain types of business entities are "persons." They are legal persons. While they may not breath, they can do the *some* of the same things as a living person, such as sue or own property. The key concept is that these 2 types of businesses are treated as a separate entity from their owner(s).

Why do I Want to Have a Corporation or Limited Liability Company for my Business Entity?

Corporations and LLCs share one important similarity for the purpose of business owners. They BOTH have limited liability. This limited liability stems from the prior concept of being separate entity. This is helpful because when you own a business you put in startup money, property, etc . . . to build the business. However, you would like to keep your home, car, and other personal assets personal. So what happens is that the corporation or the LLC you start owns anything you put in it and that's it. It owns what you put in, and your personal stuff remains yours. This is crucial because the limited liability acts like a shield, so if the company were to get sued due to injuring a customer or failing to make payments to suppliers they could only recover what is in the company and NOT from your personal assets. *Why?* Your company and you are two separate entities!

How are Corporations and Limited Liability Companies Different?

While both have a limited liability shield that separates the owner(s) from the business itself for the purpose of certain types of lawsuits, they differ in one main way. Taxes. Generally, for the purpose of the IRS a LLC is treated as a disregarded entity for its owner. This means for income taxes the owner(s) of LLC are taxed as an individual person and not as the business. This functions the same as a sole proprietorship (or a partnership in case of multiple owners). This is NOT the same for corporations: corporations are still treated as a separate entity as they were for limited liability. This time shareholder(s) (owner(s) of the corporation) are taxed as they receive distributions from their ownership of shares AND if they are working for the corporation they pay income tax for their salaries. Therefore, a corporate owner who works for the corporation will be double-taxed.¹

Further Considerations

- **Corporations:** tend to be more formal, have higher taxes, but can take greater deductions and obtain investment.
- **LLCs:** tend to be less formal and highly flexible, but do have the ability to use certain tax strategies unless an election is made; in addition, investors tend to shy away from the use of a LLC as an investment vehicle.
- **Multiple Owners:** due to the complexity of a business having several owners bylaws or operating agreements can be set in any number of ways depending on what is desired among the owners.

Contact me and I can assess your business plan, discuss the pros and cons of each business type, and then make suggestions regarding what entity is appropriate for your business.

¹ This is the case for what is known as C-Corporations. While, the rules are different for S-Corporations, the formation of a S-Corporation is more complicated and requires further consultation.