BUSINESS ENTITY TYPES: OPTIONS, PROS, AND CONS

GENESIS BANK
INSTITUTE FOR ENTREPRENEURSHIP

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Business Entity Types: Options, Pros, and Cons

When you're starting or expanding a business venture, choosing how it will be structured is one of the most important decisions you'll make.

Your business entity type has major implications when it comes to tax treatment, your personal liability as an owner, and your ability to adapt and grow. Like everything in business, there are no one-size-fits-all solutions – each entity type has a distinct set of features that you'll have to compare against your particular circumstances and goals.

Here are a few of the most common business structures and some potential benefits and drawbacks to consider:

Sole Proprietorship
If you currently work for yourself with no employees, partners, or shareholders, chances are you're a sole proprietor. If you want to protect your personal assets from potential legal action against your business or if you plan to expand, you may want to consider forming a different type of entity.

Pros:
- No state filing or fees are required.
- You have full control of business decisions.
- Taxes are simple: business income is reported on your personal tax return.

Cons:
- Because your business isn't a separate entity, you're personally liable for lawsuits or losses.
- Access to funding may be limited because you are not incorporated.
- You can't take on partners or co-owners.

Partnerships
If you plan to grow your business by taking on one or more co-owners, a partnership structure may be a sound choice. Several different subtypes include general, limited, limited liability, and limited liability limited. Each has its own advantages and disadvantages, so be sure to consult a lawyer and accountant before making a decision.

Pros:
- You may have greater borrowing capacity and access to startup capital.
- You can retain top employees as partners.
- Income can be split in a variety of ways.

Cons:
- You may be liable for your partner's actions.
- Filing requirements may be more complex.
- If partners join or leave, you may have to revalue assets and restructure the business.

Limited Liability Company (LLC)
As a legally separate entity, an LLC can be a smart way to reduce your personal liability – especially if you're in an industry with a higher risk of lawsuits or financial loss. LLCs can comprise just one principal or grow to be as big as Google (which is an LLC subsidiary of Alphabet Inc.).

Pros:
- You have limited personal liability.
- You can choose how you're taxed: either like a sole proprietorship or like a corporation.
- It's easier to form than a corporation.

Cons:
- You will have fees and filing requirements.
- You can't issue shares of stock.
- You are regulated at the state level and may be treated differently from one state to the next.

C Corporation (C Corp)
C corps are considered the default form of corporation – when you file articles of corporation in your state, you're automatically classified as a C corp. This entity type can have any number of owners and multiple classes of stock, making it more suitable for larger enterprises. Emerging entrepreneurs are unlikely to benefit from this entity type.

Pros:

- Liability is limited for company leadership, employees, and shareholders.
- You can enjoy a lower maximum tax rate.
- You can sell unlimited stock for expansion.

Cons:

- C corps are more complex and costly to form than LLCs.
- Income is double taxed – at both the company level and on the personal level.
- Rules of operation are extensive.

S Corporation (S Corp)
Because of the complexity and expense of forming a C corp, many smaller businesses take advantage of its lighter-weight, tax-advantaged counterpart: the S corp. Enterprises are eligible if they have no more than 100 shareholders and only one class of stock. The company's income is passed through to its shareholders, and the company doesn't pay any corporate income taxes.

Pros:

- You can avoid double taxation.
- Passed-through losses offset taxable income.
- Shareholders can be employees and draw salaries as well as earn dividend distributions.

Cons:

- You have to file articles of incorporation and then elect S corp status.
- You may face higher IRS scrutiny.
- Growth is limited by stockholder restrictions.

Other Options
We've covered the main types of business entities here, but federal and state laws in the U.S. make provisions for many other specialized forms, including trusts, cooperatives, public benefit corporations, professional corporations, and low-profit limited liability companies. If your business structure is out of the ordinary, a legal expert can help you explore all of your options.

Map Out Your Path to Success
As you plan out next steps for your business venture, consult your financial institution.

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