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Counselors to America's Small Business

BUSINESS ORGANIZATIONAL STRUCTURES

SOLE PROPRIETORSHIP

The sole proprietorship is the most common form of business organization. You own and operate the business and have sole responsibility and control. Essentially, you the owner **are** the business. The profits of the business are considered as personal income and therefore are taxed at your personal rate.

Advantages:

1. **Ease of formation;** fewer legal restrictions, usually less expensive than a partnership or corporation
2. **Flexibility**; quick response to business needs
3. **Profits;** sole ownership
4. **Exclusive control;** you are in-charge of all business decision making
5. **Tax deductions;** losses are tax deductable

Disadvantages:

1. **Unlimited liability;** you are responsible for the full amount of business debts even if liabilities extend to your personal assets
2. **Unstable business life;** business could be crippled or terminated by your illness or death
3. **Limited investment;** investment in the business is limited to the funds that you can raise

PARTNERSHIP

A partnership is the association of two or more people as co-owners of a business. It is a legal mechanism for profits and losses to be divided among a group of investors. The partnership does not pay taxes and all tax liability is passed through to the partners

When forming a partnership, you should have a written partnership agreement that specifies the legal obligations of each partner. A partnership agreement will specify:

1. The purpose of the partnership
2. The distribution of the earnings and responsibilities
3. Dissolution procedures
4. A mediation clause

In California, there are three types of partnerships: **"General" "Limited"** and **"Limited Liability Company (LLC)"**

General Partnership

General partners participate in the management of the business and are personally responsible for all debts.

Advantages:

1. Ease of formation
2. More skills and capital available to boost growth and performance
3. Flexibility and decision making with relative freedom from government control and special taxation
4. Does not pay taxes; revenues, etc. flow through partnership directly to the partners

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General Partnership (contd.)

Disadvantages:

1. Unlimited liability for partners
2. Personal liability of a solvent partner for the actions of unscrupulous partners
3. Unstable life of business; partnership is dissolved if a partner dies or withdraws
4. Potential for disagreements between partners, which could lead to costly dissolution

Limited Partnership

A form of partnership in which one or more General Partners run the business and those who only contribute money are called **Limited Partners**. Limited Partners are liable only to the extent of their investment and my not share in the management of the business.

Advantages:

1. The main advantage over a General Partnership is that it permits obtaining funds from investors who can participate in profits but are shielded from any losses beyond their initial investment.
2. Investors have no say in the management of the partnership

Disadvantages:

1. Profits must be shared with other investors
2. Public solicitation of Limited Partners is limited and controlled by the State Department of Corporations

Limited Liability Compaby (LLC)

A LLC has "members" instead of partners and like Limited Partners; they are only liable to the extent of their investment. Unlike Limited Partners, members may participate in the management of the company without incurring liability typical of a General Partner. The company can hire a Manager who is not a member. These details are spelled out in an "Operating Agreement".

Advantages:

1. Same as a Limited Partnership but without liability for the Managers
2. Participation in management does not change liability
3. Can be taxed like a Corporation if certain requirements are met
4. Protects investors from liability like a Corporation without the elaborate record keeping and procedures

Disadvantages:

1. State and Legal fees to establish LLC are similar to a Corporation
2. Earnings cannot be retained
3. Unlike a Corporation, there must be at least two members

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CORPORATION

The most complex form of business organization is the Corporation. A Corporation is made up of three groups of people; shareholders, directors and officers. One person may perform all three of these functions but each function has a different legal status and **must** be performed according to the law. The Corporation can borrow money, own assets and perform business functions without directly involving you or the other corporate owners (shareholders).

Advantages:

1. Limitation of the shareholders liability to a fixed amount, usually the amount invested
2. Business looks more credible than a sole proprietorship to potential suppliers, employees and bankers
3. Ownership is readily transferable
4. Separate legal existence. No limit to the length of existence
5. Relative ease of securing capital in large amount and from many investors
6. Certain expenses such as health care, insurance and pensions are deductible to a corporation but not to other business organizations

Disadvantages:

1. Activity is limited by the corporation's charter and various laws
2. Extensive government regulation and burdensome local, state and federal taxes and reports
3. Considerable expense in formation of a corporation
4. Greater administrative expenses and paperwork such as board meetings and minutes