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### **SELECTING THE STRUCTURE OF A BUSINESS ENTITY**

When you start a business, you have many choices to make. One of the important decisions that you must make is to determine what type of business organization it will be out of the various options available under law. This decision is crucial in terms of the tax consequences, the authority given to individuals associated with the company, and potential liability (that is, the financial responsibility) for each person connected with the business. As starters, you can set up your business as C-Corporation, S-Corporation, Sole Proprietorship, General Partnership, LLP (Limited Liability Partnership) or an LLC (Limited Liability Company).

How can you narrow that list down? C-Corp is an entity that is separate from its owners, regardless of what happens to shareholders, the corporation continues until it is legally dissolved. Moreover if a company intends to offer stock publicly, then the C-Corporation is the only option. S-Corporations and LLCs are not permitted to offer ownership through public offerings. Moreover C-Corp's and LLC's do not have the ownership restrictions like S Corporations, making them ideal business structures for foreign investors. In S-Corp no shareholders can be non-resident aliens. However, small businesses typically decide against a C-Corporation, because C-Corps generate two levels of federal income tax. The C-Corporation pays one level of tax when it files its federal corporate tax return, Form 1120. A second layer of tax is imposed when the C-Corporation's profits are distributed to the shareholders as dividends. Those dividends are reported and taxed on the individual's federal tax return, Form 1040. Together, these two levels of taxes are referred to as "double taxation". Overall, the tax picture for C-Corps is far from ideal for small businesses.

Conducting business as a sole-proprietor eliminates the double taxation curse. There are no corporate taxes to pay, and you only pay individual taxes on your net profits, typically reported on Form 1040, Schedule C. But sole-proprietorship business has some disadvantages also. As a sole proprietor, you lack the legal protection that corporate status gives you and owners of corporations enjoy limited liability, but sole proprietors do not. Simply stated, if you're a sole-proprietor, your personal assets are at risk if the business is sued—very risky indeed! Another disadvantage is on death of the owner sole-proprietorship immediately ceases to exist. A general partnership is very similar to the sole proprietorship, except that there is more than one owner involved. In a general partnership, not only are you personally responsible for your own actions, you become legally liable for the business liabilities and actions of your partners.

That leaves LLCs, LLPs, and S-Corporations. LLPs and LLCs are similar in many ways. One key difference is that LLPs must be owned by more than one individual but depending on State Laws LLCs can be set up with just one natural person involved. The biggest drawback of LLCs is that their legal treatment varies by state, making them a questionable choice for businesses that operate (or plan to operate) in multiple states. Furthermore, LLCs are more likely to be subject to a state's franchise taxes.

An LLC also differs from an LLP in that the LLP has the organizational flexibility of a partnership. However, if you had an LLP with two owners and one died, serious problems that might even cause the business to close could result. But most states provide for the continuation of an LLC after the disassociation or withdrawal of a member. Well, they are both "pass-through" entities that allow you to avoid double taxation, operating a business without paying corporate taxes. Net profits are reported by the owners in their individual tax returns, and both also offer protection from unlimited liability. Your liability will be limited to your investment in either entity. Moreover limit of membership also needs to be considered. The maximum number of shareholders for an S Corporation is 75 (depending on the State Laws), whereas an LLC and LLP can have unlimited number of shareholders.

Thus, while choosing an ideal business entity among C-Corp, S-Corp, Sole Proprietorship, General Partnership, LLP or an LLC you need to consider many things. Let's review the attributes of common types of business entities to help you decide.

## COMPARISON CHART FOR DIFFERENT BUSINESS ENTITIES

Characteristics	C-Corp	S-Corp	Sole Proprietorship	General Partnership	LLP	LLC
<b>Duration</b>	Perpetual	Perpetual	Dissolved if sole proprietor ceases doing business or dies	Partnership ceases to exist when certain criteria are met or if the partners decide to end the partnership	Partnership ceases to exist when certain criteria are met or if the partners decide to end the partnership	Dependent on the requirements imposed by the state of formation
<b>Ownership Rules - Minimum Number of Shareholders or Members</b>	In most states, one or more persons may form and operate a C-Corp	In most states, one or more persons may form and operate an S-Corp	One owner	Two or more persons	Two or more persons	Majority of states are allowing single-member LLCs
<b>Ownership Rules - Maximum Number of Shareholders or Members</b>	Unlimited number of shareholders allowed	Varies according to State Laws; Generally up to 75 shareholders allowed	One owner	Unlimited number of general partners allowed	Unlimited number of limited partners allowed	Unlimited number of "members" allowed
<b>Personal Liability of the Owners</b>	Generally no personal liability of the shareholders for the obligations of the corporation	Generally no personal liability of the shareholders for the obligations of the corporation	Unlimited personal liability for the obligations of the business	Unlimited personal liability of the general partners for the obligations of the business	A partner in an LLP is not liable for the malpractice of other partners. However, a Limited Liability Partnership (LLP) partner may still be jointly and severally liable for the contractual debts of the business.	Generally no personal liability of the members for obligations of the business
<b>Tax Treatment</b>	Corporation taxed on its earnings at the corporate level and the shareholders have a further tax on any dividends distributed ("double taxation")	Entity generally not taxed as the profits and losses are passed through to the shareholders	Entity not taxed as the Proprietor only pays individual taxes on the net profits	Partnership itself pays no taxes; taxation of partners at their individual rate, losses may be deducted from each partner's individual return	Partnership itself pays no taxes; taxation of partners at their individual rate, losses may be deducted from each partner's individual return	LLCs receive partnership-like tax treatment unless they elect to be taxed as a corporation.

Every business is different, and every owner has different needs and expectations. What may be appropriate under one set of circumstances may not be in another. Since advantages vary from state to state, this material is not a substitute for complete legal advice. *Readers should not take specific action based on this summary without first consulting the statute and regulations or seeking advice from a qualified professional.*

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