

## Types of Business Entities

Starting a new business is an exciting prospect, and there are several types of business entities to choose from. A business entity is a separate and distinct legal organization created to conduct business and establish legal relationships. There are many important considerations as to the type of business entity that will best suit the business you wish to conduct. Depending upon the type of business entity, creating a business entity can provide personal protection to the business owner, dictate the amount and types of taxes paid, and control how the business operates and functions internally. The following represents a summary of the types of business entities available as well as some of the pros and cons of each.

### Sole Proprietorship

A sole proprietorship is the simplest form of business. In fact, a sole proprietorship is the default form that you will have if a person begins conducting business without taking any steps to form a recognized business entity.

**CONS:** Sole Proprietorships are generally disfavored. The owner and the business are treated as one and the same. The owner of the business personally takes on all of the risks of the enterprise without any of the protections that other business entities afford. Therefore, creditors of a Sole Proprietorship can pursue collection against both the business assets and the business owner's personal wealth.

**PROS:** The cost of forming a sole proprietorship is \$0. There is no tax liability when transferring assets between the business and the owner because the business and the owner are one and the same, so legally no transfer occurs. However, these same benefits can be achieved with other business entities without all the personal liability and risk faced by the owner of a sole proprietorship.

### Limited Liability Partnership

A partnership is a type of business entity in which the owners of the business share in the profits and losses of the business. Traditionally, all owners of a partnership are personally liable for all debts and obligations of the partnership as well as for obligations and liabilities created by the conduct of other partners. However, a limited liability partnership (LLP) is an offshoot of a business partnership whereby the liability of each partner is limited. A partnership becomes an LLP by filing an application of registration with the Oregon Secretary of State. Registration as an LLP is limited to professional partnerships rendering professional services, such as lawyers, doctors, and accountants.

**CONS:** With an LLP, each partner remains directly liable for his or her own negligence, wrongful acts, misconduct, and omissions, as well as for the wrongful acts of any person under the partner's direct supervision.

**PROS:** A partner is not liable for the wrongful acts of other partners. For tax purposes, an LLP is a pass-through entity, which means all of the tax benefits and liability pass through the entity to the partners individually, thus avoiding double taxation.

### Limited Partnership

A limited Partnership (LP) is a partnership consisting of one or more general partners and one or more limited partners. General partners are responsible for managing the partnership business and are personally liable for the obligations of the business. Every limited partnership must have at least one general partner. The limited partners do not participate in the management of the business, and their liability for business obligations is limited to the extent of their capital contributions to the business.

**PROS:** Like an LLP, Limited Partnerships are treated as pass-through entities for tax purposes. Limited partners can limit their liability. General partners are vested with management control. This type of structure can work well in the context of real estate and venture capital where the business needs the benefits of partnership taxation and where the managers need to be vested with complete managerial discretion over the investment funds provided by passive investors.

**CONS:** General partners are exposed to unlimited personal liability. Most of the benefits of an LP can also be found in a Limited Liability Company (LLC), discussed below, without exposing any of the business owners to personal liability.

## Limited Liability Company (LLC)

A limited liability company (LLC) is a business entity consisting of one or more members who own the LLC. Generally, if all of the LLC formalities are followed, each of the members of the LLC are shielded from personal liability for the debts and obligations of the LLC. An LLC is formed by filing Articles of Organization with the Secretary of State. The internal workings of the LLC and the relationships between LLC members are controlled by an LLC Operating Agreement.

**PROS:** An LLC is relatively inexpensive to form. Each member of the LLC is free of any personal liability for the debts and obligations of the business. An LLC provides significant flexibility in that the LLC members can agree on how to share profits, losses, and management of the LLC in whatever way desired. An LLC is a pass-through entity for tax purposes, which avoids double taxation often incurred by corporations. An LLC is generally the preferred business entity for real estate ownership.

**CONS:** A corporation is preferred to an LLC when there is a prospect of investors in the business, or a public stock offering is likely. A corporation might also be preferred if a more complex business structure is required.

## Corporation

A corporation is a business entity which is owned by shareholders. The shareholders elect a board of directors to oversee and manage the corporation. The directors make all the major business decisions. The directors hire and fire officers. The officers are employees of the corporation that conduct the day to day operation of the business under the guidance of the directors. A corporation is formed by filing Articles of Incorporation with the Oregon Secretary of State. Corporations typically have Bylaws which dictate how the corporation is to operate and function. Shareholders typically receive share certificates as evidence of their legal ownership interest in the corporation.

**PROS:** Corporations provide delegated management with investor ownership. Ownership in a corporation is easily and readily transferable. A corporation is the business entity required for any business that intends to make a public stock offering. Generally, corporate shareholders, directors, and officers do not have personal liability for the debts and

obligations of the corporation. Shareholders of the corporation stand to lose only their investment in the corporation if the business fails.

**CONS:** It can be expensive to form and maintain a corporation compared to other business entities. As owners of the corporation, shareholders have no direct control over the management of the business. A corporation is a taxable entity, and the income earned by the shareholders is also taxable, thus creating double taxation. However, some corporations can make a Sub-S tax election whereby the IRS will treat the corporation as a pass-through entity.

## **Consulting with an attorney before starting a business is a good idea**

An attorney can elaborate on the above points as well as assist with protecting your rights, minimizing your personal risk should your business run into trouble, and help determine which business entity is more beneficial from a tax standpoint.



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