

---

## **What Are The Different Legal Structures of a Business?**

- a. The basic legal forms of business organizations include:
  - i. The sole proprietorship
    1. The individual and the business are one and the same for tax and legal liability purposes,
      - a. The proprietorship does n/ pay taxes as a separate entity,
      - b. The individual reports all income and deductible expenses for the business on schedule C of her personal income tax return,
      - c. Legal claimants can pursue all assets of the owner, n/ simply the assets used in the business
    2. Earnings of the business are taxed to the individual regardless of whether they are actually distributed in cash
      - a. There is no vehicle for sheltering income from tax
  - ii. The partnership
    1. General partnership
      - a. Business entities consisting of two or more owners,
      - b. Earnings are distributed according to the partnership agreement,
      - c. Taxes are paid only at the personal level on the partner's share of that income,
      - d. Each of the partners is jointly and severally liable—an injured party may pursue one or more of the partners for any amount.

## 2. Limited partnership

- a. Taxes are paid only at the personal level on the partner's share of that income,
- b. There are both limited and general partners
- c. General partner assumes:
  - i. Management responsibility, and
  - ii. Unlimited liability for the business
- d. The limited partner (shareholder):
  - i. Has no voice in management, and
  - ii. Is legally liable only for the amount of capital contribution plus any other debt specifically accepted

## 3. Limited liability partnership

### iii. The Corporation

#### 1. The "C" corporation

- a. Most common legal structure for large businesses
- b. A corporation's owners are generally protected from personal liability
- c. In exchange for this protection, the C corporation is a tax-paying entity. A corporation must pay taxes on its income
- d. Because the business does not get any deduction for dividends paid, the earnings of a corporation are taxed twice
  - i. First, the corporation pays a tax on its income

- ii. Second, the owners of the corporation pay a tax on the part of the corporation's earnings that is distributed to them as dividends

## 2. The S corporation

- a. Taxes are paid only at the personal level on the partner's share of that income (earnings of the business are taxed to the individual),
- b. The corporation's owners are generally protected from personal liability,
- c. To qualify for S corporation tax status, the business must meet these conditions contained in the Internal Revenue Code:
  - i. Have only one class of stock, although differences in voting rights are allowed,
  - ii. Be a domestic corporation, owned wholly by US citizens, and derive no more than 80% of its revenues from non-US sources,
  - iii. Have 75 or fewer stockholders,
  - iv. Derive no more than 25% of revenues from passive sources (interest, dividends, rents), and
  - v. Have only individuals, estates and certain trusts as shareholders (no corporations or partnerships)
- d. Election of S corporation tax status requires the unanimous, timely consent of *all* shareholders. This status may be terminated by:
  - i. Unanimous election, or

ii. If one or more of the above conditions is broken.

iv. The limited liability company (LLC)

1. Definition: Business structure designed to protect its owners from liability and from double taxation,
2. Owners of a LLC are not individually liable for the company's debts,
3. The LLC is not a tax paying entity
  - a. Income taxes are paid once—by the owners of the LLC when a part of the company's earnings is distributed to them
4. The existence of an LLC depends on compliance with the state limited liability company law—most such laws do not have restrictions on the number and type of owners like the restrictions that limit S corporations.