

[choosing a structure]

Your first step is to determine what type of business structure to have. You should be aware that your business may be legally structured in a number of different ways, and that there are certain advantages and disadvantages to each of them. You will want to select the one that is most suitable for you. Do not take this decision lightly. Your choice of structure will determine many things including: how much personal responsibility you will have for the debts and liabilities of the business, how much in taxes you will pay and how you pay them, how simple your business is to set-up and operate and what long term succession planning issues you will experience after you decide to get out of the business. Some of these structures pay their own income tax. Some do not. Some of these structures may cost you everything you have personally if there are any financial or legal problems. Some structures will limit your responsibility in these same areas. If you need help in selecting a structure for your business, please call the Small Business Development Center nearest you (see listing in this kit) or contact a lawyer and / or accountant. The five structures that you have to choose from are: the sole proprietorship, the partnership, the “c” or “s” corporation, the limited liability company, and the limited liability partnership. The following pages describe and compare these structures for you. Once you've chosen one of them you can then find that structure's Start-Up Card in the front of the kit and begin following any directions found on the card.

THE STRUCTURES YOU CAN CHOOSE FROM

Like your body has a skeleton, every business must have a structure to support it. You must select one of the available five structures that the State of Indiana offers. These include the sole proprietorship, partnership, corporation, limited liability company and a limited liability partnership. The selection of this structure must be made with care and with great thought. The structure you choose will determine how much liability you will be exposed to, how much in taxes you may have to pay, how much control of the organization you may have, etc. Each Start-Up Card has more about each structure including a definition, advantages and disadvantages and the requirements of forming and operating a small business under that structure.



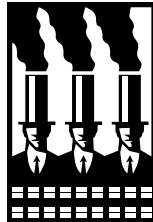
SOLE PROPRIETORSHIP

A sole proprietorship is a business owned by one individual. A sole proprietorship is not considered to be a legal entity under the law, but rather is an extension of the individual who owns it. The owner has possession of the business assets and is directly responsible for the debts and other liabilities of the business.



PARTNERSHIP

A partnership is where two or more individuals join together to run a business venture. Each of the individual partners has ownership of company assets and responsibility for liabilities, as well as authority in running the business. The authority of the partners and the way in which profits or losses are to be shared is usually controlled by the partnership agreement.



"C" OR "S" CORPORATION

A corporation is a separate legal entity which exists apart from its owners. It is sort of like its own person in that a corporation has all of the legal rights of an individual and is responsible for its own debts. It must also file income tax returns and pay taxes on income it derives from its operations. Typically, the owners or shareholders of a corporation are protected from the liabilities of the business. However, when a corporation is small and new, creditors often require personal guarantees of the owners before extending credit. Many small, eligible businesses elect to become an "s" corporation which passes its profits and losses through to its owners and avoids any corporate taxes.



LIMITED LIABILITY COMPANY (LLC)

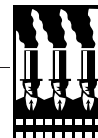
A limited liability company (LLC) is a hybrid entity that has many characteristics of a partnership and a corporation. LLCs are composed of members who may participate in the management of the company. These members have limited liability like a shareholder of corporation or a limited partner and may select a "manager" to manage all or some of the business of the company.



LIMITED LIABILITY PARTNERSHIP (LLP)

A limited liability partnership (LLP) is a general partnership that offers limited liability to all investors while preserving the opportunity to obtain pass-through tax status reserved for partnerships under federal and state laws. An LLP is much like a limited partnership, but there are no general partners exposed to unlimited personal liability, and there are no limitations on involvement in management by limited partners.

activeventures structure comparison



	SOLE PROPRIETORSHIP	PARTNERSHIP	C CORPORATION	S CORPORATION	LLC
How easy is it to start?	Easy	Moderate level of difficulty	Increased level of difficulty. You may need help	Increased level of difficulty. You may need help	Most likely you will need help from an accountant and / or attorney
How much personal liability will I have?	Unlimited personal liability	Unlimited personal liability	Generally, limited to amount of investment	Generally, limited to amount of investment	Generally, limited to amount of investment
How many owners can there be?	One	No limit	No limit	No more than 75 shareholders with a husband and wife counted as one shareholder	No limit
Who can be an owner?	Only one individual may be an owner	Any person may be an owner including: individuals, corporations, other partnerships, trusts, estates and tax-exempt entities	Any person may be an owner including: individuals, corporations, other partnerships, trusts, estates and tax-exempt entities	Generally, only individuals who are U.S. citizens or resident aliens, estates, or certain trusts may be shareholders	Any person may be an owner including: individuals, corporations, other partnerships, trusts, estates and tax-exempt entities
How is the business taxed?	No tax is imposed on a sole proprietorship, instead, all income is passed through to the owner	No tax is imposed on a partnership, instead, all income is passed through to the partners	Income is taxed at the corporate level, and then to the shareholders when distributed as dividends	No tax is imposed on an "s" corporation. Income is passed through and taxed to the shareholders	No tax is imposed on an LLC. Income is passed through and taxed to the members
Can I deduct any business losses from my taxes?	Losses are passed through to, and are deductible by, the owner of the business	Losses are passed through to, and are deductible by, partners to extent of interest in partnership	Losses for any tax year are not deductible by owners but may only be carried back or forward to offset income in other tax year	Losses are passed through to, and are deductible by, shareholders to extent of interest in s corporation	Losses are passed through to, and are deductible by, members to extent of interest in LLC
How can I allocate income among any owners?	All income is allocated to the sole proprietor	Partners may allocate income by the terms in their agreement	Preference as to the dividends can be given by issuing preferred stock, but losses are deductible only at corporate level	No difference in allocation of income is allowed since "s" corporations can only have one class of stock (besides voting rights)	Partners may allocate income by the terms in their articles of organization
What about social security and self-employment taxes?	Self-employment tax payable on income which is earned by sole proprietor	Self-employment tax payable on income which is passed through to general partners	No self-employment tax; social security tax payable on salaries paid to any employees	No self-employment tax; social security tax payable on salaries paid to any employees	Self-employment tax on income is payable by members taking an active role in management



SOLE PROPRIETORSHIP

DEFINITION

A sole proprietorship is a business owned by one individual. A sole proprietorship is not considered to be a legal entity under the law, but rather is an extension of the individual who owns it. The owner has possession of the business assets and is directly responsible for the debts and other liabilities of the business.

The sole proprietorship is the simplest of all business structures. In a sense, it does not involve a real "business" because the owner is the business and vice versa. Legally, the two are one and the same. And from a tax standpoint, the owner is basically considered self-employed, although an owner can take advantage of most of the business deductions that apply to other business structures.

As the sole proprietor, you have full and direct control over all aspects of your business. Of course, as the sole owner you also have complete responsibility for the obligations of the business. This is known as "unlimited liability," meaning you are putting not only the assets of your business on the line but your personal assets as well. Its debts are your debts. Any legal action taken against your business is being taken against you personally.

You may wish to consider this structure if you want something easy to start and operate. Also, this structure allows you to use losses of the business to offset any income that you have for tax purposes. You probably want to pass on this structure if you do not want your personal belongings (called assets) at risk. This structure, though it can have any number of employees, can only have one owner. Therefore, if you have two or more people who want to have ownership in the business, you must consider one of the other structures.



PARTNERSHIP

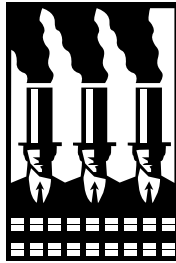
DEFINITION

A partnership is where two or more individuals join together to run a business venture. Each of the individual partners has ownership of company assets and responsibility for liabilities, as well as authority in running the business. The authority of the partners and the way in which profits or losses are to be shared is usually controlled by the partnership agreement.

Partnerships are formed when two or more people join together to conduct business. In essence, a partnership is like a "marriage." All partners are individually responsible for the obligations of the business and for the actions of their partners. Although not required, a written partnership agreement is strongly recommended to set forth the rights and responsibilities of each partner.

Even though the partnership is recognized as an entity separate from its owners, it does not pay income taxes. Instead, it computes its annual taxable income or loss. Each partner must then report his or her share of the partnership's income, gains, losses, expenses, and credits on their personal income tax return in much the same way as if the business were being operated as a sole proprietorship. A partnership is also like a sole proprietorship in that all of the partners are jointly liable for the debts and obligations of the business. Creditors can look to the assets of any one of the partners to fulfill all of the obligations of the business.

You may want to consider this structure if you have two or more owners and are looking for something easy to start and operate. You probably want to pass on this structure if you do not want your personal belongings (called assets) at risk. Also, the fact that a partner might be able to legally enter into agreements on your behalf can be an extreme liability to say the least.



“C” CORPORATION

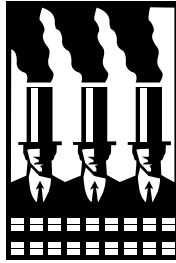
DEFINITION

A corporation is a separate legal entity which exists apart from its owners. It is sort of like its own person in that a corporation has all of the legal rights of an individual and is responsible for its own debts. It must also file income tax returns and pay taxes on income it derives from its operations. Typically, the owners or shareholders of a corporation are protected from the liabilities of the business. However, when a corporation is small and new, creditors often require personal guarantees of the owners before extending credit.

Forming a corporation is like creating a new "person" in the eyes of the law. This person is a legal entity, separate and apart from its owners. Just like you, it files its own income tax return, has its own tax number, owns property upon which it pays tax, can sue and be sued by others, and so forth. In other words, it has many of the same rights and obligations as you. But what is nice about the corporation is that it's not you. Meaning your liability as an owner in this structure can be limited, unlike a sole proprietorship or partnership.

A corporation is managed through a Board of Directors who are elected by the shareholders. The Board then selects the officers who will actually operate the business. For a small business, most states allow one person to hold all of the required offices. So this structure is even available for just one owner who wants to limit his or her obligations to some extent.

You may want to choose this structure for this very reason : to limit your personal liability and separate your personal belongings from the corporation's assets. You may want to pass on this structure for several reasons. First, it can be costly to form a corporation and difficult to operate. Since it is separate from yourself, you will most likely be considered an owner and an employee to the corporation if you provide any services to the corporation itself. This means that you must go through all the legal and tax procedures of setting up a system for employees even though there aren't any but you. Also, most start-up businesses will have to personally secure bank loans through the owners themselves and still may be held liable as officers of the business if you experience any financial or legal problems.



“S” CORPORATION

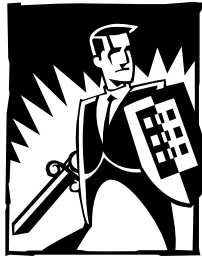
DEFINITION

An “S” corporation is a structure offered specifically for small businesses. While it offers limited liability for you as an owner, it also makes your corporation free from corporate income taxes. Instead, any income your business makes is passed on to you, the owner, where you report that income on your own personal tax return as either wages, or dividends / profits. Therefore, your money only gets taxed once rather than twice like the regular “C” corporation discussed earlier.

One problem with a “c” corporation described previously is the fact that it is a separate, legal entity apart from yourself, the owner. While this can be good from a personal liability standpoint, the problems arise in taxes. Because your corporation is separate from you, it pays income tax on its earnings. Then, any money that you take out of the business is taxed again. If you take a salary as an employee, the tax is called payroll or employment tax. If you take any profits out of the business, the profits (called dividends) are then taxed on your own personal tax return. This “double taxation” of income is the major drawback of a “c” corporation.

One possible solution to the problem is to form an “s” corporation. An “s” corporation is still a separate entity apart from its owners giving them limits on their responsibilities to the business, but it is taxed like a partnership. Meaning any money you take out is reported on your own tax return and the business itself pays no income tax. Also, unlike a “c” corporation, losses of the business can be passed through to the owners allowing them to offset any income on their own personal tax returns. So why isn't every business an “s” corporation? Because there are limits on the number of owners and even who can be an owner in forming this structure.

You may want to consider this structure if you have fewer than 75 shareholders (owners) who are individuals and are seeking a possible tax break along with limited responsibility (liability) as an owner. You may want to pass on this structure, if you are making excessive amounts of income which could put you into a tax bracket higher than that of a “c” corporation.



LLC (LIMITED LIABILITY COMPANY)

DEFINITION

A limited liability company (LLC) is a hybrid entity that has many characteristics of a partnership and a corporation. LLCs are composed of members who may participate in the management of the company. These members have limited liability like a shareholder of a corporation or a limited partner and may select a "manager" to manage all or some of the business of the company.

A Limited Liability Company (LLC) is a structure formed under state law. Unlike the partners in a partnership, none of the members of an LLC are personally liable for its debts. An LLC can be classified as either a partnership or a corporation for income tax purposes. It is classified as a partnership if it has no more than two of the following corporate characteristics: (1) centralization of management, (2) continuity of life, (3) free transferability of ownership, and (4) limited liability.

LLCs are composed of members who may participate in the management of the company. These members have limited liability like a shareholder of a corporation or a limited partner and may select a "manager" to manage all or some of the business of the company.

You may want to consider this structure for your business if you want to limit your responsibility as an owner (limited liability). An LLC is also more flexible than a "s" corporation because there is no limit to the number of members, there may be more than one class of members, and partnerships, corporations, and individuals may be members. You may want to pass on this structure because it can be costly to form since you most likely need the assistance of an attorney. Also, many of the tax and legal implications are still being developed, and you must give up two advantages of a corporation as stated above.



LLP (LIMITED LIABILITY PARTNERSHIP)

DEFINITION

A limited liability partnership (LLP) is a general partnership that offers limited liability to all investors while preserving the opportunity to obtain pass-through tax status reserved for partnerships under federal and state laws. An LLP is much like a limited partnership, but there are no general partners exposed to unlimited personal liability, and there are no limitations on involvement in management by limited partners.

A Limited Liability Partnership (LLP) is a relatively new type of business structure. This structure was developed in response to the huge personal liability problems faced by partners of law and accounting partnerships in the last few years. LLPs can be thought of as simply a special type of general partnership that exists under state law.

The partners in an LLP normally remain personally responsible for the business' debts and legal liabilities. The partners are also liable for the responsibilities related to their own professional acts and for the liabilities related to problems of persons under their supervision. The good news is that LLP partners are generally not responsible for the professional errors of the other partners or most employees of the business.

You may want to consider this structure if you have been operating as a partnership and want to limit your responsibility for your partner's actions. You may want to pass on this structure because it still does not offer you limited responsibility for your actions or offer any protection of your personal belongings if you or someone under your supervision is at fault. Also, it is not completely clear what your business structure is in states that do not have LLP statutes. Therefore, the LLP may be treated as a general partnership meaning that all of the partners have complete personal responsibility for the debts and liabilities of the business.