

# Choosing the Legal Structure



Early in the process of starting your business, you must decide what legal form you would like your business to take. The form is partially decided by the ownership structure and aids in determining the structure of the management team. This decision is best made with the help of your attorney and your accountant. The ten basic types of organizations, and the advantages and disadvantages of each, are outlined below.

## Sole Proprietorship

With this type of organization, you are the sole owner of assets and the sole employer. At the same time, you are solely responsible for all profits and losses, and all personal assets are subject to claim from business creditors.

### Advantages

- low startup cost
- owner in direct control
- no business taxes
- all profits go to owner
- simplest to form
- flexibility to change quickly to match the market

### Disadvantages

- unlimited personal liability
- lack of continuity
- difficulty in raising capital
- no tax-free fringe benefits to the owner
- decisions based on the limited knowledge of owner
- unstable due to potential death or illness of owner

## Partnership

For a listing of the types of partners, see Appendix B. In a partnership, two or more persons contribute money, property, labor and/or skill in return for a share of the profits and losses of the venture. As with the sole proprietorship, each individual is personally liable for business losses. For examples of items typically included in a partnership agreement, see Appendix C.

### Advantages

- additional sources of venture capital
- broader management base
- possible tax advantage
- business itself pays no taxes
- decision making more flexible than in a corporation
- ease of formation

### Disadvantages

- unlimited liability
- potential of conflict between partners
- divided authority
- difficulty in raising additional capital
- difficulty in finding and keeping suitable partners
- more record keeping than a sole proprietorship
- firm bound by the acts of any partner

## Corporation

A corporation is a structure separate from the people who own it. When you file Articles of Incorporation with the Secretary of State, your business becomes a separate legal entity in which you (and your partners, if you have them) are simply employees.

### Advantages

- limited individual liability
- ownership is more easily transferred
- continuous existence
- legal entity
- possible tax advantages
- easier to raise capital
- tax-free fringe benefits to owner and employees

### Disadvantages

- double taxation to both the corporation and its shareholders
- losses sustained by the corporation are not available to the stockholders
- may be subject to Indiana Gross Income Tax
- extensive government regulations and reports
- employees have less incentive without profit sharing

The disadvantages of incorporating may be avoided if you qualify to become an S-corporation (tax election filed with IRS). If you have seventy-five or fewer shareholders, a single class of stock, and meet various other criteria, you may become an S-corporation. You are then exempt from corporate income taxes, and corporate profits and losses are claimed by individual shareholders.

## Limited Liability Company (LLC)

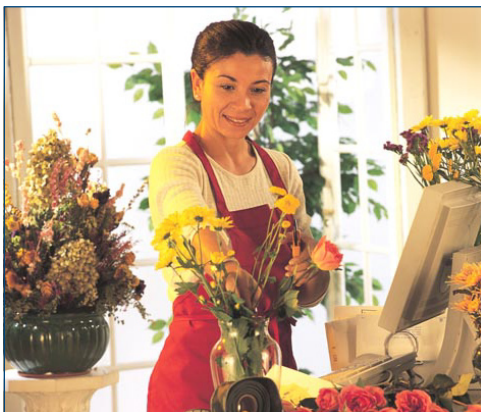
An LLC is an unincorporated entity that stands alone, but still enjoys the advantages of limited liability and pass-through taxation. It is established when Articles of Organization are filed with the Secretary of State. A written operating agreement contains the rules and regulations for the business.

### Advantages

- pass-through taxation at federal and state levels (similar to partnership or S-corporation) via check-the-box IRS regulations
- can have any number of members and different classes of members
- limited liability
- all members may participate in management

### Disadvantages

- must have more than one owner for pass-through tax treatment
- LLC is recognized in most, but not all, states



**Limited liability companies are recognized in most states.**