University of Richmond School of Law™

INTELLECTUAL PROPERTY & TRANSACTIONAL LAW CLINIC

CHOOSING THE PROPER BUSINESS ENTITY

Choosing the proper business entity based on your business goals is crucial. The proper business entity will help protect your personal assets from the liabilities of the business. Factors to be considered are: capital-raising strategies, degree of liability, ownership and day-to-day operation of the business, tax implications, and future growth and/or exit strategies.

Sole Proprietorship

A sole proprietorship is a business that is owned and operated by one person. The owner is entitled to all profits of the business, but is also personally liable for all obligations. A sole proprietorship is considered the simplest form of business entity because few formalities are required.

General Partnership

A general partnership is formed when two or more people co-own a business for a profit. A written partnership agreement is not required, but is a good idea. The partnership agreement governs the amount of control each partner will have and also how the partners will share profits or losses. Typically each partner is jointly and severally liable for all obligations of the partnership. Partners are responsible for the income taxes on their share of partnership profits.

Limited Partnership

A limited partnership is a partnership formed by two or more people with at least one general partner and at least one limited partner. The general partner controls the management of the business and is usually liable for all obligations of the partnership. The limited partner is usually only an investor with limited liability. For tax purposes, limited partnerships act like general partnerships, where each partner pays personal income taxes on their share of the partnership profits. A limited partnership must be registered with the state, but has no additional recordkeeping requirements.

Corporation

A corporation is a legal entity separate from its owners, the shareholders. A corporation typically consists of directors, officers, and at least one shareholder, each with different levels of responsibility, legal duty, and control. Corporations are formed by filing articles of incorporation with the state and have strict record keeping requirements. A corporation must comply with federal laws and the laws of each state in which it conducts business. The manner in which business profits are taxed depends entirely on the structure of the corporation.

Limited Liability Company (LLC)

A Limited Liability Company (LLC) is a separate legal entity with one or more owners, called members. The liability of the owners is usually limited to their investment. LLCs have few record-keeping requirements, but should have an operating agreement and must file articles of organization with the state. LLCs offer tremendous organizational flexibility and can be taxed like corporations or like partnerships.

	MANAGEMENT/ PROFITS	LIABILITY	TAXES	ADMINISTRATION
Sole Proprietorship	Sole proprietor has total control of business operations and receives all profits.	No separation of liability – all of the proprietor's personal and business assets are at risk.	All profits are taxed as income of sole proprietor.	Must obtain business license and register trade name. No administrative requirements.
General Partnership	Control and profits are shared between partners according to the partnership agreement.	Partners are liable for all obligations of the partnership and liabilities of other partners.	Acts as pass-through entity. Each partner pays tax on their share of profits. May also require self-employment taxes.	No formal administrative requirements other than obtaining local licenses and permits.
Limited Partnership	General and limited partners share in the control and profits of the partnership according to the partnership agreement.	Limited partners: no liability for obligations of limited partnership. General partners: same liability as partners in a general partnership.	Acts as pass-through entity. Both general and limited partners pay tax on their share of profits.	Articles of association must be filed, but generally no record keeping or tax filing requirements.
Corporation	Shareholders: ownership rights, including election of directors. Directors: govern general affairs and appointment of officers. Officers: manage day-to-day operations of the business.	In general, neither directors, officers, nor shareholders are personally liable for any of the obligations of the Corporation.	**S-Corp (acts as pass-through entity):** All profits are taxed as income of each shareholder. **C-Corp:** Business income is taxed at corporate level; dividends are taxed as shareholders' income.	Requires bylaws and filing of articles of incorporation; typically has comprehensive record keeping and tax filing requirements.
Limited Liability Company (LLC)	Member profits and management procedures are directed by the operating agreement.	Usually limited to the member's investment in the company.	Can be taxed like corporation or partnership.	Only articles of organization must be filed, but should also have an operating agreement.

Business Entity Checklist

- ☐ Choose the proper business entity for your situation.
- ☐ Prepare formation documents and agreements and register with the state.
- ☐ Obtain a federal Employment Identification Number.
- ☐ Open a business bank account.
- ☐ Consult with an insurance professional.
- ☐ Register with the Va. Department of Taxation.
- ☐ Satisfy local licensing requirements.
- ☐ Contact the appropriate state agencies with oversight of your industry.
- ☐ Determine your liability for unemployment tax.

Contact Us

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