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Business Ownership Structures

Learn about the corporation, LLC, partnership, and sole proprietorship.

Before you can decide how you want to structure your business, you'll need to know what your options are. Here's a brief rundown on the most common ways to organize a business:

- sole proprietorship
- partnership
- limited partnership
- limited liability company (LLC)
- corporation (for-profit)
- nonprofit corporation (not-for-profit), and
- cooperative.

Sole Proprietorships and Partnerships

For many new businesses, the best initial ownership structure is either a sole proprietorship or -- if more than one owner is involved -- a partnership.

Sole Proprietorships

A sole proprietorship is a one-person business that is not registered with the state like a limited liability company (LLC) or corporation. You don't have to do anything special or file any papers to set up a sole proprietorship -- you create one just by going into business for yourself.

Legally, a sole proprietorship is inseparable from its owner -- the business and the owner are one and the same. This means the owner of the business reports business income and losses on his or her personal tax return and is personally liable for any business-related obligations, such as debts or court judgments.

Partnerships

Similarly, a partnership is simply a business owned by two or more people that hasn't filed papers to become a corporation or a limited liability company (LLC). You don't have to file any paperwork to form a partnership -- the arrangement begins as soon as you start a business with another person. As in a sole proprietorship, the partnership's owners pay taxes on their shares of the business income on their personal tax returns and they are each personally liable for the entire amount of any business debts and claims.

Sole proprietorships and partnerships make sense in a business where personal liability isn't a big worry -- for example, a small service business in which you are unlikely to be sued and for which you won't be borrowing much money for inventory or other costs.

Limited Partnerships

Limited partnerships are costly and complicated to set up and run, and are not recommended for the average small business owner. Limited partnerships are usually created by one person or company (the "general partner"), who will solicit investments from others (the "limited partners").

The general partner controls the limited partnership's day-to-day operations and is personally liable for business debts (unless the general partner is a corporation or an LLC). Limited partners have minimal control over daily business decisions or operations and, in return, they are not personally liable for business debts or claims. Consult a limited partnership expert if you're interested in creating this type of business.

Corporations and LLCs

Forming and operating an LLC or a corporation is a bit more complicated and costly, but well worth the trouble for some small businesses. The main benefit of an LLC or a corporation is that these structures limit the owners' personal liability for business debts and court judgments against the business.

What sets the corporation apart from all other types of businesses is that a corporation is an independent legal and tax entity, separate from the people who own, control and manage it. Because of this separate status, the owners of a corporation don't use their personal tax returns to pay tax on corporate profits -- the corporation itself pays these taxes. Owners pay personal income tax only on money they draw from the corporation in the form of salaries, bonuses, and the like.

Like corporations, LLCs provide limited personal liability for business debts and claims. But when it comes to taxes, LLCs are more like partnerships: the owners of an LLC pay taxes on their shares of the business income on their personal tax returns.

Corporations and LLCs make sense for business owners who either (1) run a risk of being sued by customers or of piling up a lot of business debts, or (2) have substantial personal assets they want to protect from business creditors.

Nonprofit Corporations

A nonprofit corporation is a corporation formed to carry out a charitable, educational, religious, literary, or scientific purpose. A nonprofit can raise much-needed funds by soliciting public and private grant money and donations from individuals and companies.

The federal and state governments do not generally tax nonprofit corporations on money they take in that is related to their nonprofit purpose, because of the benefits they contribute to society.

Cooperatives

Some people dream of forming a business of true equals -- an organization owned and operated democratically by its members. These grassroots business organizers often refer to their businesses as a "group," "collective," or "co-op" -- but these are often informal rather than legal labels. For example, a consumer co-op could be formed to run a food store, a bookstore, or any other retail business. Or a workers' co-op could be created to manufacture and sell arts and crafts. Most states do have specific laws dealing with the set-up of cooperatives, and in some states you can file paperwork with the secretary of state's office to have your cooperative formally recognized by the state. Check with your secretary of state's office for more information.