When you start a business, you may be placing all of your personal assets at risk. If your company loses a big lawsuit or can’t pay its bills, you are liable to lose your home, car, jewelry and/or savings in order to cover your company debts. Business owners can avoid this disaster, however, by forming a business entity that limits their legal liability. Here is a guide to help you understand different types of business entities available to you, along with some of their benefits and drawbacks.

**SOLE PROPRIETORSHIP**
If you own your own business and don’t organize the company as an alternative business entity, then you’re a sole proprietor, and the company is a sole proprietorship. You and your business are legally inseparable and, as explained above, you will be personally liable for any debts your company can’t pay.

**GENERAL PARTNERSHIP**
(usually just called a “partnership”). If you own a business together with anyone else, and you don’t form an alternative business entity, then you and your co-owners are partners, and your business is a partnership. Partnerships are much riskier than sole proprietorships because EACH partner is personally liable for ALL of the debts of the business. You could lose your house to satisfy business debts that one of your partners may have incurred - even if you are only a passive investor and have nothing to do with management.
C CORPORATION
(usually just called a “corporation”). Owners (or “shareholders”) of a C-Corporation generally can lose no more than the amount they have invested in the company - your personal assets are protected. (There are, however, some specific debts for which shareholders can still be personally attacked, including unpaid taxes and, in the case of New York corporations, employee salaries). The C-Corporation is a particularly attractive entity for a business seeking investors, given its ready-made and easily transferable currency of “shares,” plus a well-defined set of rules governing the rights and duties of managers (or “officers”) and shareholders. On the other hand, many small companies not seeking investment find C-Corporations to be tax inefficient and cumbersome to administer.

S CORPORATION
An S Corporation is essentially a C-Corporation that elects to be treated as a “small business” for tax purposes. Unlike a C-Corporation, which first needs to pay taxes on its earnings, and whose shareholders then have to pay separate taxes on their dividend income from the company (sometimes leading to “double taxation”), the income of an S-Corporation “passes through” directly to its shareholders’ personal tax returns. (Sole proprietorships and partnerships also receive “pass-through taxation.”)

Like a C-Corporation, an S-Corporation provides you with limited liability, a ready-made currency of ownership (“shares”), and clear rules. Still, most serious investors are not attracted by pass-through taxation - and if even one owner transfers just one share to a prohibited entity (including those used by most investors), the company will default back into C-Corporation status for five years. Furthermore, as with C-Corporations, many small companies find S-Corporations cumbersome to administer.

LIMITED LIABILITY COMPANY
(or an “LLC”). Owners (or “members”) of a limited liability company have both limited liability, plus the choice of whether to be taxed as a C-Corporation or to receive pass-through taxation. LLCs are flexible and tend to be simple for companies of any size to administer, so long as there are not many owners - in fact, a single-member LLC can be nearly as easy to run as a sole proprietorship. On the other hand, LLCs are less attractive for widely-owned businesses (and for companies seeking investment) because they lack a ready-made, easily transferable ownership currency of “shares,” and because the laws governing them have yet to be fully tested in court (the LLC is a relatively new entity).

LIMITED PARTNERSHIP
(sometimes called an “LP”). A limited partnership is a partnership where one
partner manages the business (the “general partner”) and all others are limited to passive investment (the “limited partners”). The general partner is liable for all of the company’s debts, while limited partners have no liability beyond the amount they invest in the company. Limited partnerships are popular among businesses that expect substantial tax losses in their early years (companies that invest money, etc.), as partners can “pass through” tax losses to their personal tax returns, offsetting other income and lowering their personal taxes. Limited partnerships, however, can be rather complicated and expensive to set up.

OTHER ENTITIES
While the above entities will suffice in most situations, other structures are available. “Limited liability partnerships” (LLPs), “professional corporations” (PCs), and “professional limited liability companies” (PLLCs) for example, are popular among professionals who cannot limit their liability for professional services (law, medicine, etc), but who nonetheless wish to limit their liability for other business debts (rent, etc.) and for professional services provided by their co-owners. Likewise, “nonprofit corporations” can be formed for religious, charitable, literary, scientific or educational purposes, resulting in limited liability as well as tax-exempt treatment (though “investments” must be irrevocably gifted to the organization, and you will never be able to sell your interest for a profit).

SEEK ADVICE
It is critical to limit your personal liability for the debts of your company - but you must plan properly to meet your specific needs. The above discussion greatly simplifies the issues involved, and you should speak with a qualified corporate attorney to help you decide which entity is right for your particular situation. Your attorney should also be able to help you legally form your entity, as well as structure any agreements with your co-owners.

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