Choosing a business structure

Eventually one of the business decisions you'll need to make when planning your business will be its structure. For legal and tax purposes, every business needs to comply with a specific 'structure' which are:

- Sole proprietorship where you run the business on your own.
- Partnership when you have two or more owners of the business.
- LLC business which combines the benefits of a partnership and limited liability.
- Corporation where the business is a separate legal entity, shares are issued and allocated to shareholders.

You must select one and then operate your business according to its guidelines. It's important to choose the structure that best suits the needs of your business.

Registration

You will need to register a business regardless of the structure, and it's useful to protect your business name at the same time.

Going solo

Deciding to run your business as a sole proprietor is your simplest option, and the one that many small business owners choose as it's the easiest to set up. It's the default structure if you don't choose anything else.

The advantages of going solo include:

- Having the freedom to take full control and make all the decisions without anyone else to ask
- Low set-up costs or legal fees
- Some tax advantages, such as deducting losses and expenses from your personal income
- You earn all the profit.

There are also some perceived disadvantages of becoming a sole owner, such as:

- Being accountable for all parts of your business, so all the debts and losses are your own
- A creditor can claim against your personal assets as well as the business if you don't pay a debt
- No-one to share the load or work with who has complementary skills.

It's the most straightforward way to structure your business, less paperwork, and you are up and running immediately. You can also decide later to change the structure (add in a partner or form a LLC) as your business grows.

Teaming up

A partnership is a group of two or more people who set up a business together, often where there are synergies to offer more to customers than on your own.

The pros of starting a partnership include:

- It's inexpensive to set up a partnership agreement, shared equally between you and your partners
- Each member of the partnership is liable for the debts of the business with shared responsibility for losses while profits are divided between partners
- If income from the partnership is negative (the business loses money) you and your partners can include the share of the loss against your individual tax returns
- You have the support and (ideally) complimentary skill sets in the business.

The potential cons of creating a partnership are that:

- There's no legal difference between you and your business, so you're still liable for all business activities in the same way a sole proprietor is
- Each person in your partnership is responsible for its debts, regardless of whether you directly caused the debt or not
- Finding the right partner can be difficult and there's always the possibility of disagreements on the direction of the business
- If one or more of the partners leave, the partnership is ended.

Note there are two types of partnerships in the US:

- 'Limited' partnerships, where one partner has unlimited liability (often it's the person that started the business or is more involved in the business), and other partners have limited liability. Exactly who relates to which, is documented in a partnership agreement

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- 'Limited liability' partnerships, where all partners have limited liability, protecting each partner from debts against the partnership and any actions of other partners.

If you're forming a partnership, finding the right person or people is essential. You want to be in business with someone you can trust, because you're responsible for their decisions. While having a partner who brings a different perspective to the discussion is great, being in a partnership where decision making is delayed due to difference of opinions could impact on your success.

Limited Liability Company (LLC)

An LLC lets you take advantage of the benefits of both the corporation and partnership business structures and is a very common business structure. You can have more than one owner in the business (called members).

Pros

- As in the name, there is limited liability if something goes wrong. Your personal assets can be protected from business debts and lawsuits against the business
- LLCs are taxed as either a sole proprietorship or partnership, depending on whether there's one member or multiple members. Your share of business income and expenses are reported on your personal tax return, so you pay personal income tax on profits
- You don't need to have shareholder meetings or have a board
- If approved, you have exclusive rights to use your business name in your state
- It helps with credibility to have LLC at the end of your name (suppliers and customers know you're one level above a sole trader or partnership).

Possible cons

- You need to register your LLC, so there are a few legal costs, and you may need to file annual reports
- Membership isn't easy to transfer like a corporation with shares, where one person can sell their shares to another. If there is a change in ownership, you may need to dissolve the LLC and form a new one
- It isn't as easy to get outside investment like it is with a corporation

Forming a corporation (C corp)

A corporation is a separate legal entity from you, where it's set up formally with a certain number of shares (which you decide). People (you and others) are then allocated a percentage of these shares which indicates ownership of the corporation. You'd get a salary (and maybe a dividend) from the corporation.

Advantages include:

- Your personal assets and the corporation assets are separate, so if the company is in debt, it's less likely you will be personally liable (unless you've given a personal guarantee)
- A corporation lives on despite change of management, so you can more easily pass on or sell the business to others
- It's more professional and credible for suppliers and customers
- You can sell shares to raise money for expansion or growth projects.

The disadvantages can be:

- The cost in legal fees to set-up
- Yearly compliance costs.

Next steps

- It's important to understand your options, their tax implications, and their advantages and disadvantages. Spend some time learning about the different business structures so that you can choose the best one for you and your business.
- It's a good idea to get advice when deciding on a business structure so consult either a solicitor, accountant or any professional adviser to check you're making the right decision.
- If you're unsure what to do, visit your local business advice center.