

FORMS OF ORGANIZATION

There are four common forms of business organization— sole proprietorship, partnership, corporation, and Limited Liability Company. The following section highlights the advantages and disadvantages of these forms of organization. It is strongly recommended that you seek advice from your accountant and attorney on which legal entity best suits your needs.

Sole Proprietorship

A sole proprietorship is a business that is owned by an individual who is solely responsible for all aspects of the business. The owner is personally responsible for all debts of the firm, even in excess of the amount invested in the business. All that is necessary to establish as sole proprietorship is to obtain the necessary local licenses. Sole proprietorship is the easiest of the legal structures to set up and is the most common small business legal structure.

Advantages	Disadvantages
Owner receives all profits Profits taxed only Owner makes all decisions Low organizational costs Few legal restrictions Simple to organize Easy to discontinue	Unlimited liability No separate legal status Difficulty in raising capital

Partnership

A general partnership is a legal entity that is jointly owned by two or more persons. As in the sole proprietorship, the owners are personally responsible for all debts of the firm, even those debts in excess of the amount invested in the business. An attorney should be consulted to help prepare the partnership agreement. Limited partnerships must be filed with the State Corporation Commission (SCC). The requirements for establishing a limited partnership include filing a certificate that contains the name of the partnership, its specified office location, its registered agent, and the name of each general partner.

Advantages	Disadvantages
Easy to organize Separate legal status Profits taxed only once Taxed at partner’s rate	Unlimited liability to general partner Divided decision making Transferability of ownership

Corporation

A corporation is a business that is formed and authorized by law to act as a single person, although constituted by one or more persons, and is legally endowed with rights and responsibilities. There are two general types of corporations: regular and Subchapter-S. Each has numerous variations.

It is advisable to consult an attorney when organizing a corporation to assure full compliance with Virginia and federal laws. All corporations are required to file articles of incorporation and amendments with the SCC. Corporations that do business in more than one state must comply with the federal laws regarding interstate commerce and with the various state laws.

Regular Corporation (C Corporation)

The regular corporation is the better-known corporate structure. This type of corporation requires several procedures: obtaining a corporate taxpayer identification number from the Internal Revenue Service (IRS), obtaining a state certificate of incorporation, and holding a stockholders' meeting to elect directors who in turn elect the corporate officers. Each corporation must hold a stockholder's meeting at least once each year, keeping minutes of the meeting on the record. A corporation is either publicly held or closely held, usually depending on the number of stockholders. A closely held corporation is generally one where all the stock is owned by persons, or members of their immediate family, who are actively involved in the management of the business. This kind of corporate structure provides the liability protection, the benefits of being incorporated, and the absence of the public scrutiny applied to a partnership.

Advantages	Disadvantages
Limited liability Transfer of ownership Ability to raise larger dollars	Double taxation High organizational costs

S Corporation

Another form of corporation is the Subchapter-S Corporation. A new venture can have no more than 75 shareholders and no more than 20 percent of its income earned from passive investments. The losses of the corporation can be deducted by the individual stockholders and can be earned forward or backward to offset any gains. This is a significant advantage in attracting capital from individual investors who want a tax write-off the first several years when the corporation is losing money. When the new venture starts to earn a profit, the structure can be changed from an S corporation to a regular corporation with its accompanying tax laws.

S Corporation requirements:

- Must be a U.S. Corporation
- Shareholders must be U.S. residents
- Limited number of shareholders
- Only one class of stock

- No corporate or partnership shareholders
- Consent of all shareholders required for S Corporation election

Advantages	Disadvantages
Limited liability Profits may be taxed only once Ability to raise larger dollars	Extensive record keeping necessary High organizational costs Heavily regulated by State and Local laws S Corporation requirements

B Corporation

Another subtype of corporation, “Benefit” Corporations are a new structure for corporations that wish to promote public good. The name derives from the goal of a B Corporation being to produce profit in conjunction with other social benefits. Currently, this structure is recognized in some form by 36 states. Responsibilities and requirements are similar to standard corporations. In addition, B Corporations must declare their commitment to public benefit, in some cases the specific benefit they produce, as well as file an annual benefit report assessing itself against a third party positive impact standard. Conversion into and out of this structure requires a supermajority (2/3) vote of shareholders.

Advantages	Disadvantages
Limited liability Transfer of ownership Ability to raise larger dollars Ability to focus on social good and shareholders instead of solely shareholders	Extensive record keeping necessary Annual report filing Must produce some public benefit in addition to profit High organizational costs Heavily regulated by State and Local laws

Limited Liability Company (LLC)

A limited liability company is an unincorporated association. Limited liability companies must be filed with the SCC. The requirements for establishing a limited liability company include filing articles of organization that set forth the name of the company, its principal office address, and its registered agent. All amendments must be filed with the SCC.

Advantages	Disadvantages
Limited liability for each member No limitation on number of members Simplicity in operation & formation (required to file articles of organization) Flow-through tax advantage	Limited tax savings for fringe benefits Regulations vary among states regarding taxation issues Some states require that an LLC must terminate in 30 years Some states impose a corporate or franchise tax on LLCs