# Forms of Business Organization

One of the first decisions that you will have to make as a business owner is how the business should be structured.  All businesses must adopt some legal configuration that defines the rights and liabilities of participants in the business’s ownership, control, personal liability, life span, and financial structure.  This decision will have long-term implications, so you may want to consult with an accountant and attorney to help you select the form of ownership that is right for you.  In making a choice, you will want to take into account the following:

•**size and nature** of your business.  
•The **level of control** you wish to have.  
•The **level of “structure**” you are willing to deal with.  
•Tax implications of the different organizational structures.  
**•Expected profit (or loss)** of the business.

An overview of the **four basic legal forms of organization**:

1. **Sole Proprietorship**
2. **Partnerships**
3. **Corporations**
4. **Limited Liability Company follows**

### Sole Proprietorship

The vast majority of small businesses start out as sole proprietorships.  These firms are owned by one person, usually the individual who has day-to-day responsibility for running the business.  Sole proprietorships own all the assets of the business and the profits generated by it.  They also assume complete responsibility for any of its liabilities or debts.  In the eyes of the law and the public, you are one in the same with the business.

**Advantages of a Sole Proprietorship**

• **Easiest and least expensive** form of ownership to organize.  
• Sole proprietors are in **complete control**, and within the parameters of the law, may make decisions as they see fit.  
• The business is **easy to dissolve**, if desired.

**Disadvantages of a Sole Proprietorship**

• Sole proprietors have unlimited liability and are legally responsible for all debts against the business.  Their business and personal assets are at risk.  
• May be at a disadvantage in **raising funds** and are often limited to using funds from personal savings or consumer loans.  
• May have a **hard time attracting high-caliber employees**, or those that are motivated by the opportunity to own a part of the business.  
• Some **employee benefits** such as owner’s medical insurance premiums are not directly deductible from business income (only partially as an adjustment to income).

### Partnerships

In a Partnership, **two or more people share ownership of a single business**.  Like proprietorships, the law does not distinguish between the business and its owners.  The Partners should have a **legal agreement** that

how decisions will be made,

profits will be shared,

disputes will be resolved,

how future partners will be admitted to the partnership,

or what steps will be taken to dissolve the partnership when needed;

Yes, its hard to think about a “break-up” when the business is just getting started, but many pjdartnerships split up at crisis times and unless there is a defined process,

They also must decide up front how much time and capital each will contribute, etc.

**Advantages of a Partnership**

• Partnerships are relatively easy to establish; however time should be invested in developing the partnership agreement.  
• With more than one owner, the **ability to raise funds** may be increased.  
• The profits from the business flow directly through to the partners’ personal tax return.  
• Prospective employees may be attracted to the business if given the incentive to become a partner.

**Disadvantages of a Partnership**  
• Profits must be shared with others.  
• Since decisions are shared, disagreements can occur.  
• Some employee benefits are not deductible from business income on tax returns.  
• The partnership may have a limited life; it may end upon the withdrawal or death of a partner.

**Types of Partnerships that should be considered:**

**1. General Partnership**  
Partners **divide responsibility** for management , as well as the shares of **profit or loss** according to their internal agreement.  Equal shares are assumed unless there is a written agreement that states differently.

**2. Limited Partnership and Partnership with limited liability**  
“Limited” means that most of the partners have limited liability (to the extent of their investment) as well as **limited input** regarding management decision, which generally encourages investors for short term projects, or for investing in capital assets.  This form of ownership is not often used for operating retail or service businesses.  Forming a limited partnership is more complex and formal than that of a general partnership.

**3. Joint Venture**

**Joint Venture Definition**

A joint venture is a strategic alliance where two or more people or companies agree to contribute goods, services and/or capital to a common commercial enterprise.**Acts like a general partnership**, but is clearly for a limited period of time or a single project.  If the partners in a joint venture repeat the activity, they will be recognized as an ongoing partnership and will have to file as such, and distribute accumulated partnership assets upon dissolution of the entity.

### Corporations

A Corporation, chartered by the state in which it is headquartered,

A Corporation can be taxed;

it can enter into contractual agreements.

The owners of a corporation are its shareholders.

shareholders elect a board of directors to oversee the major policies and decisions.

The corporation has a life of its own and does not dissolve when ownership changes.

**Advantages of a Corporation**

• Shareholders have limited liability for the corporation’s.  
• Generally, shareholders can only be held accountable for their investment in stock of the company.  (Note however, that officers can be held personally liable for their actions, such as the failure to withhold and pay employment taxes.  
• Corporations can raise additional funds through the sale of stock.  
• A Corporation may deduct the cost of benefits it provides to officers and employees.  
•This election enables company to be taxed similar to a partnership.

**Disadvantages of a Corporation**

• The **process of incorporation** requires more time and money than other forms of organization.  
• Corporations are **monitored** by federal, state and some local agencies, and as a result may have more paperwork to comply with regulations.

**Limited Liability Company (LLC)**

The LLC is a relatively new type of business structure that is now permissible in most states.  It is designed to provide **limited liability features of a corporation and the tax efficiencies and operational flexibility of a partnership**.  Formation is more complex and formal than that of a general partnership.

LLC’s must not have more than two of the four characteristics that define corporations:

Limited liability to the extent of assets;

continuity of life;

centralization of management;

free transferability of ownership interests.

## Advantages

* Choice of tax regime. An LLC can elect to be taxed as a sole proprietor, partnership, [S corporation](http://en.wikipedia.org/wiki/S_corporation) or [C corporation](http://en.wikipedia.org/wiki/C_corporation) (as long as they would otherwise qualify for such tax treatment), providing for a great deal of flexibility.
* Limited liability, meaning that the owners of the LLC, called “members”, are protected from some or all liability for acts and debts of the LLC depending on state shield laws.
* Much less administrative paperwork and record keeping than a corporation.
* Pass-through taxation(i.e., no double taxation), unless the LLC elects to be taxed as a C corporation.
* Using default tax classification, profitsare taxed personally at the member level, not at the LLC level.
* LLCs in some states can be set up with just one natural personinvolved.
* For real estate companies, each separate property can be owned by its own, individual LLC, thereby shielding not only the owners, but their other properties from cross-liability.

## Disadvantages

* It may be more difficult to raise financial capitalfor an LLC.
* Typically, LLCs will choose to be taxed as a partnership to avoid double taxation, which occurs in corporations..

### LLC benefits

The benefits of creating an LLC typically outweigh any perceived disadvantages and are typically unavailable to [sole proprietorships](http://www.bizfilings.com/sole-proprietorship.aspx) and general partnerships.

* **Protected assets.** LLCs provide limited liability protection to their owners (members), who are typically not personally responsible for the business debts and liabilities of the LLC. Creditors cannot pursue the personal assets (house, savings accounts, etc.) of the owners to pay business debts. Conversely, in a sole proprietorship or general partnership, owners and the business are legally considered the same—leaving personal assets vulnerable.
* **Pass-through taxation.** LLCs typically do not pay taxes at the business level. Any business income or loss is "passed-through" to owners and reported on their personal income tax returns. Any tax due is paid at the individual level.
* **Heightened credibility.** Forming an LLC may help a new business establish credibility with potential customers, employees, vendors and partners because they see you have made a formal commitment to your business.
* **Limited compliance requirements.** LLCs face fewer state-imposed annual requirements and ongoing formalities than [S corporations](http://www.bizfilings.com/s-corporation.aspx) and [C corporations](http://www.bizfilings.com/c-corporation.aspx).
* **Flexible management structure.** LLCs are free to establish any organizational structure agreed upon by the company owners. LLCs can be managed by the owners (members) or by managers, unlike corporations which have a board of directors who oversee the major business decisions of the company and officers who manage the day-to-day affairs.
* **Few restrictions.** There are few restrictions on who can be an LLC owner or how many owners an LLC may have (unlike S corporations).

### Potential LLC disadvantages

LLCs may have some potential disadvantages, including:

* **Formation and ongoing expenses.** To form an LLC, Articles of Organization must be filed with the state and the applicable state filing fees paid. Many states impose ongoing fees, such as annual report and/or franchise tax fees. While these fees often are not very expensive for small businesses, LLC formation is more expensive than that of a sole proprietorship or general partnership, both of which are not required to file formation documents with the state. A few states, such as New York and Arizona, also require LLC owners to publish notice of the LLC formation in local newspapers for several weeks. This can be costly.
* **Transferable ownership.** Ownership in an LLC is often harder to transfer than with a corporation. With corporations, shares of stock can be sold to increase ownership. Typically with LLCs, all owners must approve adding new owners or altering the ownership percentages of existing owners.
* **Less precedent.** Because the LLC is a newer type of business structure, there is not as much case law or legal precedent for LLCs as there is for corporations.

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| Definition of 'Liability' A company's legal debts or obligations that arise during the course of business operations. Liabilities are settled over time through the transfer of economic benefits including money, goods or services. |
|  | explains 'Liability' Recorded on the balance sheet (right side), liabilities include loans, accounts payable, mortgages, deferred revenues and accrued expenses. Liabilities are a vital aspect of a company's operations because they are used to finance operations and pay for large expansions. They can also make transactions between businesses more efficient. For example, the outstanding money that a company owes to its suppliers would be considered a liability.   Outside of accounting and finance this term simply refers to any money or service that is currently owed to another party. One form of liability, for example, would be the property taxes that a homeowner owes to the municipal government.   Current liabilities are debts payable within one year, while long-term liabilities are debts payable over a longer period. |

# Dividend

**Dividends**

are payments made by a [corporation](http://en.wikipedia.org/wiki/Corporation) to its shareholder members. It is the portion of corporate profits paid out to stockholders.[[1]](http://en.wikipedia.org/wiki/Dividend#cite_note-0) When a corporation earns a [profit](http://en.wikipedia.org/wiki/Profit_%28accounting%29) or surplus, that money can be put to two uses: it can either be re-invested in the business (called [retained earnings](http://en.wikipedia.org/wiki/Retained_earnings)), or it can be distributed to shareholders. There are two ways to distribute cash to shareholders: [share repurchases](http://en.wikipedia.org/wiki/Share_repurchases) or dividends.[[2]](http://en.wikipedia.org/wiki/Dividend#cite_note-Simkovic_Disclose-1)[[3]](http://en.wikipedia.org/wiki/Dividend#cite_note-Simkovic_Owner-2) Many corporations retain a portion of their earnings and pay the remainder as a dividend.

A dividend is allocated as a fixed amount per share. Therefore, a shareholder receives a dividend in proportion to their shareholding. For the joint stock company, paying dividends is not an [expense](http://en.wikipedia.org/wiki/Expense); rather, it is the division of after tax profits among shareholders. Retained earnings (profits that have not been distributed as dividends) are shown in the shareholder equity section in the company's balance sheet - the same as its issued share capital. [Public companies](http://en.wikipedia.org/wiki/Public_company) usually pay dividends on a fixed schedule, but may declare a dividend at any time, sometimes called a [special dividend](http://en.wikipedia.org/wiki/Special_dividend) to distinguish it from the fixed schedule dividends.

[Cooperatives](http://en.wikipedia.org/wiki/Cooperative), on the other hand, allocate dividends according to members' activity, so their dividends are often considered to be a pre-tax expense.

Dividends are usually paid in the form of cash, store credits (common among retail [consumers' cooperatives](http://en.wikipedia.org/wiki/Consumers%27_cooperative)) and shares in the company (either newly created shares or existing shares bought in the market.) Further, many public companies offer [dividend reinvestment plans](http://en.wikipedia.org/wiki/Dividend_reinvestment_plan), which automatically use the cash dividend to purchase additional shares for the shareholder.

The word "dividend" comes from the [Latin](http://en.wikipedia.org/wiki/Latin_language) word "*dividendum*" ("thing to be divided").