



# How To Choose A Business Structure

If you are operating a small business, at some point the time will come when it starts growing and you will have to register your business and define its legal structure. Choosing your business structure is a vital decision, for it will have a great impact on the tax that you will be paying, your business goals, and your business earnings. It is also crucial to decide on the right structure for your business because for one thing, if things take a turn for the worse regarding debts or legal issues, the outcome might be disastrous for your financial situation. Here is where your business structure comes in to minimize the damage and shield you from such unfortunate mishaps.

## **7 Reasons why you would want to establish a business structure:**

- Give rise to the credibility of your business.
- Reduce personal liability.
- Reduce tax liability.
- Better liquidity. (Ability to sell or transfer ownership)
- Easier access to the banking services.
- Involving partners or bringing on investors.
- Establishing credit in the name of the business.

In this guide, we'll be discussing and going through the different types of business structures. What you will need to do is; go through them well, see which one better fits your business while considering some factors (which are listed below), and then consult an accountant or a lawyer before taking your final decision.

## **Factors to consider when looking through options for a business structure:**

- Protecting the owner(s) from personal liability.
- Minimizing tax exposure.
- How profits will be shared.
- How decisions will be made.
- The compliance burden of the business structure.

## **The six main types of business structures:**

### **1. Sole Proprietorship**

The Sole Proprietorship is the simplest form of conducting business which does not need large initial costs. This is where you get to operate your business on your own and take the sole responsibility for it. You may hire other people to assist you, but there will be some rules and regulations implied on you as a sole proprietor employer.

#### **Pros**

- Simplicity.
- No Double taxation.

## **Cons**

- Potential for greater tax liability.
- Personal liability for business debts and obligations.

## **2. Partnership**

As your business expands, your sole proprietorship might grow into a partnership. This partnership might bring together two or more people to form their business. All participating individuals in the partnership are held accountable and take on equal responsibility for the business. Subsequently, both the profits and the liabilities are equally shared. There should be an agreement among the partners determining the details of different possible scenarios.

## **Pros**

- Shared responsibilities and pooled resources.
- Formal Incorporation is not required.
- No double taxation.
- Flexible time horizon.

## **Cons**

- Potential for greater tax liability.
- Personal liability for business obligations.
- Dependent on human relationships.
- Shared decision-making processes.

## **3. Limited Liability Company (LLC)**

The limited liability company is sort of a hybrid business structure. Like a corporation, it limits the personal liability of its owners, yet allows the taxing of the profits to be either on a member level or a corporate level. Owners in a limited liability company are responsible for the debts of the business only to the amount to which they have invested in their capital, which lowers the risk. The business gains credibility by being registered through a company formation agent.

## **Pros**

- Limited liability of owners.
- Lower regulatory requirements.
- Double taxation is avoidable.
- Corporations and other entities can be shareholders.

## **Cons**

- Members are considered self-employed.
- Potential for greater tax liability.

#### **4. Limited Liability Partnership (LLP)**

The structure of the limited liability partnership is a combination of the traditional partnership and the limited liability company. Here, the members are required to register themselves as self-employed. However, they are liable for the debt of the business only to the extent of their capital investment.

##### **Pros**

- Limited liability of owners.
- Lower regulatory requirements.
- Double taxation is avoidable.
- Corporations and other entities can be shareholders.

##### **Cons**

- Members are considered self-employed.
- Potential for greater tax liability.

#### **5. S-Corporation (S-corp)**

In the S-Corporation structure, profits are taxed on shareholder's return. The shareholders also have limited liability but their assets can't be seized to fulfill debts incurred by a business. This structure allows having one class of stock and no more than 100 shareholders.

##### **Pros**

- Limited liability for owners.
- No double taxation.
- Greater legitimacy.
- Easier to raise capital.

##### **Cons**

- Ownership class size is limited.
- Potentially costly to establish and operate.
- Greater record-keeping and regulatory burden.
- "Reasonable Compensation" requirements.

#### **6. C-Corporation (C-corp)**

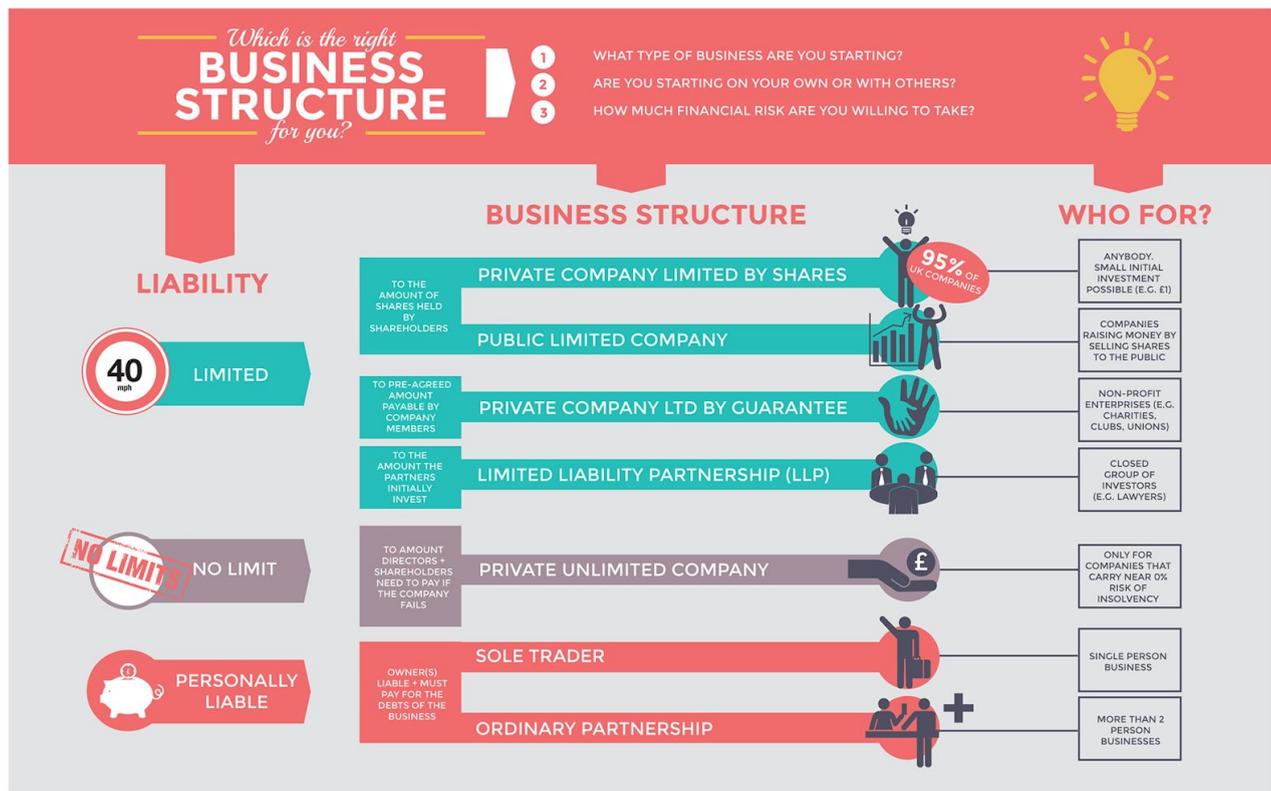
In the C-Corporation, the profits are double taxed. It is first taxed on the business level, and then, it is taxed a second time on an individual basis when the earnings are distributed on the shareholders. The shareholders here have limited liability for the business's debts. The C-Corporation allows having multiple classes of stock and an unlimited number of shareholders.

## Pros

- Limited liability for owners.
- Easier to generate capital.
- Greater legitimacy.

## Cons

- Potential tax disadvantage.
- Expensive to establish.
- Greater regulatory burden.
- Potential for many stakeholders.



Careful consideration should be taken when you are deciding on your business structure. You need to consider the kind of growth that you foresee for your business and give some thought to the liabilities associated with it. Once you have chosen a structure, switching to another structure is possible but rather hard, so it is best for you to think thoroughly about the business structure that would give you the optimal benefits both now, and on the long run.