

How to Choose Your Business Entity

It is normal to feel overwhelmed when it comes to forming a business entity. Once you create your entity, you have to live with it unless you go through a complicated process to change it. Because of that, you want to make the right decision in the beginning. Unfortunately, though, many business owners make mistakes and wish they could start all over again. You can avoid mistakes by educating yourself before you form your business structure. Go over some common questions and answers so that you can find the right entity for your needs. Then, you will be ready to take the next step by filing the necessary paperwork.

Do you need to protect your personal assets?



If you have a lot of personal assets, the idea of forming a new business might be frightening. What happens if someone sues your business? Can they wipe out your assets?

It depends on what business entity you choose.

Some business structures protect your personal assets, while others don't offer any liability protection. If you go with a

structure without liability protection, your assets will be up for grabs if you are sued.

Both limited liability companies (LLC) and corporations protect business owners' assets. The liability protection means that customers can only go after your business assets if you're sued. In other words, your business will be responsible for paying any judgment that your insurance doesn't cover. Your personal assets can't be touched.

If you want to run a small business, go with an LLC. If you're going to run a big business with lots of employees, you may want to scale up to a corporation.

What if you have minimal assets?

Liability protection is great if you have a lot of assets, but what if you don't? Do you really need to form an LLC or a corporation?

If you are running a small business and have minimal personal assets, you could form a sole proprietorship or partnership. These business entities cost less to form, and they have fewer tax consequences. That is the tradeoff for not having liability protection. They cost less and are easier to form, but you can be liable if you're sued.

It is important that you get adequate insurance if you have a sole proprietorship or partnership. Your insurance will offer you some protection, even if your business structure does not.

Do you want the best entity for tax purposes?

If so, the entity you choose will depend on what you want out of your tax situation.

Do you want simplicity? If so, you need to go with a sole proprietorship, partnership, or LLC. All three are "pass-through" entities. That means that your profits and losses pass through to your personal taxes. You do not actually pay taxes as a business. You pay them as an individual. If you are running a small business and want something simple, these three business structures are perfect.

However, you don't get to take advantage of the low corporate tax rate with those three entities. If you don't mind a bit of complexity, consider going with a corporation. Corporations pay taxes, but they get special corporation tax rates for the first \$50,000 to \$75,000 made. It's important to note that corporations also have to pay taxes on shareholder dividends, but if you're running a small company, that likely won't be an issue.

Is having the full control necessary for you?

Some business owners want to maintain control when running their businesses, while others are more than happy to hand some decision-making duties over to a board of directors. If control is an issue, you need to stick with a sole proprietorship, partnership, or LLC. Corporations include a board of directors that handles the decision making, so you will lose some control if you go with a corporation.

Do you need money to fund your business?

If you need outside sources to support your business, you should choose your business structure accordingly. In general, it is much easier for corporations to obtain funds from third parties. You can get the funds in various ways. Selling stock is one popular option, but you aren't limited to stock sales.

Do you want protection and flexibility at the same time?

You might want more protection than you can get with a sole proprietorship or partnership, but the rigidity of a corporation scares you. If so, you can meet in the middle with an LLC. Relatively easy to form and run, you can pass your profits through to your personal bank account, and you don't have to take orders from a board of directors. [G1]

Making the Right Decision for Your Business

Choosing a business entity is an important decision, so consider seeking outside help. A business advisor will take the time to learn about your situation and then guide you toward the best business entity for your needs. That way, you will have the protection and benefits that you need for your business



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