

Choosing the Appropriate Business Structure

COMPARISON OF DIFERENT FORMS OF BUSINESS

Taxation	taxed as an individual	taxed as an individual;	corporate tax rate; dividends taxable to individual shareholders, as in the case of a partnership	taxed to individual owners at their individual rates, certain gains are taxable to the corporation as well	members taxed individually
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Limited Liability Company

In 1992 the Arizona legislature enacted the Arizona Limited Liability Company Act. This statute allows for the creation of a Limited Liability Company (LLC), which is a hybrid business entity. It combines the corporate attribute of limited liability with the income tax advantages of partnerships.

The LLC is created by filing articles of organization with the Arizona Corporation

Commission. An LLC is owned by members instead of shareholders or partners, and its operation is governed by an operating agreement that resembles a partnership agreement or corporate bylaws.

An LLC may have a designated manager (who need not be a member), or it may be managed by members of the LLC who can actively manage the organization without undertaking the risk of personal liability.

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Each of the five forms of business entities has advantages and disadvantages. Here is a brief comparison of the forms. It may not be extensive, but it gives the major aspects of each form.

	Sole Proprietorship	Partnership	Corporation	S Corporation	Limited Liability Company (AZ)
Ease of Start-up	easy; may need a license	moderate	need legal advice	need legal advice	moderate
Cost of Start-up	low	moderate to high (legal)	moderate to high (legal)	moderate to high	moderate
Liability	unlimited (you are liable for all company obligations)	general: unlimited; limited: limited to investment	limited to stock investment	stockholders are not generally liable for corporate debts, but often have to guarantee loans; corporate officers may be liable to the IRS for failure to withhold and pay withholding taxes on employees' wages	members have no joint or several personal liability for a debt or other obligation of the LLC
Ownership (vote/share)	owner is the business	partners are the business	separate legal entity	one class of stock; no more than 35 shareholders who are individuals or estates; cannot have any non-partner, resident aliens; must be headquartered in the U.S.	members may actively participate in management
Transfer	sell the business (must start a new entity)	sell the business or interest (new entity)	sell stock	sell stock	sell business or interest
Termination	at death of owner, sale or closing	at withdrawal of any partner	unlimited lifespan	unlimited lifespan	withdrawal of member
Management	owner runs the firm	one person or divided management	usually Board of Directors then operating management	usually Board of Directors then operating management	either appointed manager or members

Determining the business format that is most appropriate for your operations is one of the first steps. To do this, study the various legal and tax-related implications associated with the various forms of business organizations.

Several forms of business organizations exist. Listed below are the recognized forms of business with a brief description of each. Included on the following pages are the general advantages and disadvantages of each form. This list is not extensive, but it gives the major aspects of each form.

Consult an attorney and/or a certified public accountant for further advice and information to determine the right form of legal structure for your business.

Sole Proprietorship

The sole proprietorship is the simplest and most common form of business organization. It is defined as a business that is owned by one individual. The owner is personally responsible for all debts of the firm. Profits are considered personal income and taxed accordingly.

Partnership

A partnership is an association of two or more persons joined together to carry on trade or business for profit. As in the sole proprietorship, partners are personally responsible for all debts of the firm.

The partnership's existence is usually formalized through preparation of a partnership agreement. Formal partnership agreements should be prepared by an attorney. In general, partnership agreements outline each partner's share of investment, control, income, gain, loss, deductions, and credits.

Corporation

A corporation is the most complex type of business organization. It is formed by law as a separate entity, completely distinct from those who own it. It also has its own rights and responsibilities.

In forming a corporation, potential shareholders offer money and/or property in exchange for capital stock. The stockholders are the owners of the corporation. The managers of the firm may or may not be stockholders.

Businesses that incorporate in Arizona must file Articles of Incorporation with either the Arizona Corporation Commission. Businesses that incorporate on the Navajo Nation must file Articles of Incorporation with the Navajo Nation Regulatory Department. A corporation not incorporated on the Navajo Nation but wishing to do business on the Navajo Nation must register as a foreign corporation with the Navajo Nation Business Regulatory Department.

S Corporation

S Corporations, sometimes called sub-chapter S corporations, elect not to be subject to federal corporate income tax. The shareholders include their shares of the corporation's income, deductions, loss, and credit, or their shares of non-separately computed income or loss, as part of their personal income. A corporation can become an S corporation if: 1) all shareholders consent to the corporation's election of S Corporation status, 2) the corporation has a permitted tax year, and 3) an IRS Form 2553 (Election by a Small Business Corporation) is filed to indicate the choice of S Corporation status. The corporation must qualify as an S Corporation at the time it files Form 2553.

For further information on S Corporations, get IRS publication 589, "Tax Information on S Corporations," from the IRS Forms Distribution Center, Ranch Cordova, CA 95743-0001.