Guide to Business Entities

Business Entities Snapshot

This chart provides a quick comparison of common business entities and how they operate. Please see pages 2-4 for more detailed information about a specific business entity.

	SOLE PROPRIETORSHIP	GENERAL PARTNERSHIP	LIMITED PARTNERSHIP	C CORPORATION	S CORPORATION	LIMITED LIABILITY CORPORATION (LLC)	LIMITED LIABILITY PARTNERSHIP (LLP)	PROFESSIONAL CORPORATION
Business Owned By	Sole Proprietor	Partners	Partners	Shareholders	Shareholders	Members	Partners	Shareholders
Number of Owners	One	One to unlimited	One general and one limited partner minimum	One to unlimited	1 to 100	One to unlimited	Two or more, but all owners must be individuals (not entities)	One to unlimited
Liability Protection	No	No	Yes for limited partners	Yes	Yes	Yes	Generally all partners receive liability protection, but some states require at least one partner to be personally liable for business debts	Yes (except for professionals' own malpractice)
Management Decisions	Made by sole proprietor	Made by partners	Made only by general partners	Made by Board of Directors	Made by Board of Directors	Made by members unless LLC elects manager to manage	Made by partners unless LLP elects manager to manage	Made by Board of Directors
Transfer of Ownership	Easy	Consent of all partners usually required by agreement	Consent of all partners usually required by agreement	By stock transfer (securities law may limit)	By stock transfer (securities law may limit)	Consent of all members usually required by agreement	Consent of all members usually required by agreement	By stock transfers (transfers generally restricted to persons providing professional services)
Tax Treatment	Disregarded entity — all income, etc., recognized on sole proprietor's individual income tax return	Paid by partners unless corporate tax status elected	Paid by partners unless corporate tax status elected	Paid by corporation	Passed through and paid by shareholders	Paid by members unless corporate tax status elected	Paid by partners unless corporate tax status elected	Paid by corporation (35% flat tax)

Common Business Entities

Sole Proprietorship

A sole proprietorship is created when one person is engaged in business for himself or herself. The sole proprietor can engage employees to carry out the business but personally retains the profits and assumes the losses of the business. A sole proprietor is fully liable for all business obligations to the full extent of his or her personal as well as business assets. For tax purposes, a sole proprietorship is considered a disregarded entity and all tax passes through to the individual owner on his or her personal tax return.

General Partnership (GP)

A general partnership is an association of two or more persons (or entities) who carry on a business as co-owners. No special filings, certificates or documents need to be filed to form a general partnership, and, unless otherwise agreed, the control and management of the partnership is shared equally by all the partners. There is no liability protection for the partners in a general partnership; each partner is liable for the obligations of the partnership to the extent of his or her business and personal assets. The general partnership is a pass-through entity where all items of income, credit, deduction, gain and loss are passed through to the partners, unless the partnership elects to be treated as a corporation under the "check-the box" regulations.

Limited Partnership (LP)

A limited partnership is a form of partnership that offers limited liability protection to the limited partners. This type of partnership is formed by two or more persons and requires that at least one person be a general partner and one be a limited partner. A general partner has the same liabilities as a partner in a general partnership while a limited partner is liable only to the extent of his/her business interest in the partnership. To preserve limited liability, a limited partner generally may not participate in the control or management of the partnership's business.

This type of entity is authorized by state statute and cannot be formed unless statutory requirements are satisfied. Failure to observe the appropriate formalities may result in the formation of a general partnership with general, rather than limited, liabilities for all partners. Like a general partnership, a limited partnership is a pass-through entity unless it elects to be treated otherwise.

Given the lack of control and management ability of the limited partners, interests in LPs may qualify for a lack-of-control discount when determining the value of an LP interest for transfer purposes.

Family Limited Partnership (FLP)

A Family Limited Partnership is merely a planning term used for a limited partnership that is restricted to family members and which generally holds family investments and/or business interests. Because ownership of an FLP is limited to family members and generally cannot be transferred to individuals outside the family, interests in an FLP may receive a lack-of-marketability discount in addition to the lack-of-control discount commonly used with LPs. A lack-of-marketability discount may apply in valuing an FLP interest because the transfer restrictions placed on the FLP make the interests less marketable than an LP interest without any such restrictions. These discounts can help to reduce estate, gift and income tax liability of the transferring partner and thus can be an excellent way for older generations to pass assets to the younger generation while enjoying impressive tax benefits.

Corporation (C Corp or S Corp)	A corporation is a type of business entity, created under the laws of the state in which it is incorporated, that offers its owners, known as shareholders, limited liability protection. If the corporation fails, shareholders typically are only liable to the extent of their investment in the company and are not personally liable for the debts and obligations of the corporation itself. Shareholders are the owners of the company and elect the board of directors, who in turn oversee and direct corporation affairs and decision-making, but are not responsible for day-to-day operations. The directors elect the officers to manage daily business affairs. For tax purposes, a corporation is automatically designated as a "C corporation" unless it elects to be treated as an "S corporation." A C corporation is taxed first at the corporate level and again at the individual shareholder level when income is later distributed to the shareholders as dividends. If an election is made to treat a corporation as an S corporation, the profits and losses of the business skip the corporate-level tax and instead are "passed through" to the shareholders, similar to the taxation of partnerships. C corporations have no restrictions on ownership, but S corporations do. S corporations are restricted to no more than 100 shareholders, and shareholders must be U.S. citizens/residents. S corporations cannot be owned by C corporations, other S corporations, LLCs, partnerships or many trusts. Also, S corporations can have only one class of stock (disregarding voting rights), while C corporations can have multiple classes.
Limited Liability Companies (LLC)	An LLC is a business entity permitted by state law that combines characteristics of both the partnership and corporate structures. Like a corporation, an LLC offers its owners, referred to as "members," limited personal liability for the debts and actions of the LLC. For tax purposes, however, an LLC is automatically taxed as a pass-through entity, like a partnership or sole proprietorship, unless the members specifically elect to have it taxed as a corporation. The LLC is a popular choice of business entity because of its simplicity and increased management flexibility as compared to a corporation, which governs through a Board of Directors. Members of an LLC can choose to share management equally among the members or can appoint one or more managers to manage the business. Moreover, the use of an LLC provides liability protection without necessitating a general partner as compared to the use of limited partnerships. Many states now permit a single member LLC, which is taxed as a sole proprietor (a single level of tax) but the individual member enjoys limited liability. Similar to LPs and FLPs, discounts may be available to reduce the value of a transferred interest in an LLC.

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Limited Liability Partnership (LLP)	A limited liability partnership is another type of partnership that provides all of its owners with limited personal liability. The partners of this type of entity are generally not personally liable for the debts, liabilities or obligations of the partnership, but remain personally liable for their own negligence, wrongful acts, errors, or omissions. An LLP is distinct from limited partnerships in that limited liability is granted to all partners and not just to a subset of "limited partners." In addition, all partners of an LLP may take an active role in the management of the partnership as opposed to limited partners in an LP. Note, some states require at least one member of an LLP to have personal liability for the debts of the business. Limited liability partnerships are particularly well suited to professional groups, such as lawyers and accountants, because of the liability protection afforded from another partners' negligence or malpractice. In fact, in some states LLPs are only available to certain professionals. Similar to limited partnerships and limited liability companies, a limited liability partnership is sanctioned by state statute and all requirements and formalities must be adhered to.
Professional Corporation (PC)	A professional corporation is a type of corporation authorized by state law for a particular group of licensed professionals, including, but not limited to, lawyers, doctors, accountants and architects. Unlike a traditional corporation where shareholders and officers are generally free from personal liability, a professional corporation does not protect a shareholder from personal liability associated with his or her own negligence or malpractice. Other shareholders of a PC, however, are protected from the negligent actions of another. A professional corporation is generally taxed as a "qualified personal service corporation," which requires a 35% flat tax rate at the corporate level. In some states, limited liability partnerships and/or limited liability companies may offer the same benefit as a professional corporation.

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