SEOLS
Southeastern Ohio Legal Services

SELECTING YOUR BUSINESS STRUCTURE

When you start your small business, you'll need to decide how you want to operate your business. Choosing what type of business, you operate involves two related decisions: First, tax treatment, and second, liability of the business owner. "Liability" means who has financial responsibility for business debts.

WHAT ARE THE TYPES OF BUSINESS I CAN OPERATE? There are four business structures individuals can choose to operate under: 1) sole proprietorship, 2) limited liability company, 3) partnership, or 4) corporation.

90% of small businesses chose either a sole proprietorship or a limited liability company (LLC).

WHAT IS A SOLE PROPRIETORSHIP?
A sole proprietorship is the simplest type of business organization. This structure is owned and run by a single person. It is simple, low cost, and fast to set up. No separate legal entity (Legal entity means any company or organization that has legal rights and responsibilities separate and apart from the owner) is created. Most people working for themselves would be considered "sole proprietors."

If the sole proprietorship is sued, the sole proprietor would have what is called 'unlimited liability'; this means that any lawsuits against the business put the business owner's personal money and property at risk and vice versa.

For taxation, the sole proprietor reports their income, like W2 income, retirement distributions, etc. on their individual tax return, Form 1040. They report their income and expenses from the business on what's called a Schedule C. The Schedule C is included with the owner's Form 1040.

HOW IS A LIMITED LIABILITY COMPANY (LLC) DIFFERENT?
A limited liability company, or LLC, is a legal entity created under state law. To learn how to create an LLC in Ohio, you can visit ohiosos.gov. A benefit to an LLC is that the owners are protected from the liabilities of the business, which means that if the business goes into debt or is sued, your personal money and property (assets) are protected.

For taxation, a single owner LLC will report their income on a tax return just like a sole proprietor. The income and expenses of their LLC will be reported on a Schedule C and included with their Form 1040. The same thing happens for a multiple-owner LLC; however, each owner will report their income based on their share of the business.

IS A PARTNERSHIP THE SAME AS AN LLC?
No. Unlike an LLC, a partnership is a relationship between two or more people who come together to start a trade or business. There is no separate legal entity created. Each person contributes money, property, labor, or skills, and they each expect to share both the profits and/or the losses of the business. Any number of people may join in a partnership. Like sole

proprietorships, if the partnership is sued or can't pay its debts, the partners are each fully liable—or responsible—for the debt.

Taxation of a partnership can be complicated. The Partnership must file an information return. An information return simply reports the income, deductions, gains, losses, etc. from its operations, but it does not pay income tax. Instead, profits and losses reported on the information return are then reported by the partners on their individual tax returns based on their share in the business. If you decide to form a partnership, make sure you have a good accountant and tax preparer who has experience with partnerships.

HOW IS A CORPORATION DIFFERENT?

Like an LLC, corporations are treated by the law as legal entities. That is, the corporation has a life separate from its owners and has rights and duties of its own. The owners of a corporation are known as shareholders. Forming a corporation involves the transfer of money or property or both by the shareholders in exchange for shares in the corporation. The shareholders get their share of profits when they are paid by the corporation as dividends. The other benefit of setting up a business as a corporation is that, like an LLC, the shareholders are not personally liable for the debts of the corporation. Instead, the corporation is liable for the debt.

For tax, the profit of a corporation is taxed to the corporation when earned, and then is taxed to the shareholders when distributed as dividends. The corporation will need to file its own annual tax return. The taxation of a corporation is very nuanced, so make sure you have a good accountant and tax preparer who has experience with corporations.

The Low-Income Taxpayer Clinic is funded, in part, by a grant from the Internal Revenue Service.
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How to contact SEOLS:
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