

# Business Legal Structures

Some of the more common business structures are:

- sole proprietorship
- general partnership
- limited partnership
- limited liability partnership
- corporation (including S corporations)
- professional associations
- limited liability companies
- business trusts
- professional corporations

There are six common issues that distinguish the different business forms:

- taxation
- liability
- risk and control
- continuity of existence
- transferability
- expense and formality

Taxation and risk and control are the more significant issues. In addition to these common issues, there also are issues specific to each form.

A one-person company generally has only three choices of business form: sole proprietorship, corporation, or a limited liability company. Multiple people typically have the additional options of general partnership, limited partnership, or a limited liability company.

Liability is a risk that one exposes oneself to when starting a business. Two types of risk are *tort risk* and *contract risk*. A tort is an intentional or unintentional harm to the person or property of another. Some examples of tort risk are worker injury, product liability, automobile liability, and general liability, such as when somebody falls on a wet floor. Examples of contract risk are financing risk and risk with vendors and customers.

Tort risk can be protected against by using insurance. 99% of businesses can get an insurance policy against all tort risks. Excess insurance beyond standard liability limits often is not needed. For example, in medicine most people will settle claims at policy limits, because otherwise too many activists would protest if physician's personal assets could be easily taken.

Liabilities associated with contract risk can be limited in the contract itself. For example, software user agreements may have a general liability limitation equal to the price paid for the software.

Traditionally, there was a tradeoff between liability and taxation. However, S corporations and LLC's have changed that tradeoff so that a company can have limited liability and pass-through taxation.

### **Sole Proprietorship**

As the simplest form of business legal structure, the sole proprietorship is viewed as being one and the same as its owner. The sole proprietor incurs little expense in setting up this form of business, and it is the most common structure among small businesses.

### **General Partnership**

The general partnership is an association between two or more people in business seeking a profit. General partnerships have pass-through taxation and the owners are personally liable for the debts of the business. General partnerships can be formed with little formality, but because more than one person is involved it is wise to have a written partnership agreement stipulating the terms of the partnership.

### **Limited Partnership (LP)**

The limited partnership comprises general partners who run the business and are exposed to personal liability, and limited partners who invest in the business and have only their invested capital at risk. Limited partnerships are especially useful for raising capital since they permit investors to participate financially in the business without incurring personal liability.

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

The limited liability partnership is similar to a limited partnership except that all partners in an LLP enjoy limited liability. Limited liability partnerships are common among professionals such as attorneys and accountants, who are not allowed to use corporations to limit their liability. Limited liability partnerships offer both the pass-through taxation of a partnership and the liability protection of a corporation.

### **Corporation**

The corporation is the most common form of business entity among larger companies. Unlike sole proprietorships and partnerships, corporations are separate and distinct from their owners in the eyes of the law. As a separate entity, corporations have several distinguishing characteristics including limited liability, easy transferability of shares, and perpetual existence. Corporations also have centralized management who may be different persons from the actual owners.

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

Venture capitalists do not like the flow-through taxation associated with LLC's. However, in many cases an LLC is better than an S corporation for taxes because there are fewer hurdles and income can be allocated more flexibly.

## **The Uniform Commercial Code**

Businesses are formed under state laws and are governed by the Uniform Commercial Code (UCC), which made business laws similar in all states. Before the UCC, businesses had to know and deal with the different laws in all of the states in which they operated. Note however, that Louisiana still is under the Code of Napoleon. Other uniform laws include the UPA, RUPA, ULPA, and RULPA.

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