

A brief overview of your entity options

Sole proprietorship: a business entity that is owned and run by one individual. There is no legal distinction between the owner and the business. All profits and losses flow directly to the owner of the business. The proprietor owns all of the business assets and all of the debts of the business belong to the proprietor. The owner of a sole proprietorship has unlimited liability.

Partnership: a business entity in which two or more partners/owners share with each other the profits and losses of the business. For tax purposes a partnership can be more beneficial because it allows pass through taxation: the partnership does not generally incur a tax on its profits before the money is distributed to the partners. Like a sole proprietorship, each partner is personally liable for the partnership liabilities. Many partnerships have partnership agreements that help define what each partner's role is in the business.

Limited Partnership (LP): A Limited Partnership is a business entity in which there is a least one general partner who actively manages the business and who is personally liable for the obligations of the business. The general partner is the only one with the authority to bind or take action on behalf of the partnership (ie; enter into contracts). The "limited" partner is a partner who cannot, by law, have an active role in managing the company. The limited partner has no liability for the obligations of the business. In a limited partnership the allocation of profits and losses is based on each partner's contributions to the partnership.

Limited Liability Partnership (LLP): is a general partnership in which the partners are not personally liable for the debts and obligations of the General Partnership. Decision making in an LLP is done by a majority vote of the partners and all partners have a statutory right to participate in management of the company. Like a regular partnership, the LLP allows for "pass through" taxation. Limited partners in a LLP are not liable for the actions of the other limited partners.

Limited Liability Company (LLC): An LLC is a statutorily created, hybrid business entity that is considered a separate legal entity, with its own rights and legal obligations, existing separately from its organizers/owners. An LLC is unique because it provides liability protection, like a corporation, but allows its organizers to claim business profits and losses on their personal taxes (known as "pass through" taxation), like a partnership. LLC's can be managed by the owner/members or by a manager who has been appointed by the member(s). Unlike limited partners, LLC members may participate in management without risking personal liability for company debts. LLCs are good for passive investment situations such as land deals or restaurants. LLC's are generally much easier to run than a corporation; they do not require the corporate formalities and record keeping rules required by corporations.

C-Corporation (C-Corp): A C-Corp is the typical type of corporation that you hear about in the news. Companies like Google, IBM and Nike are C-Corps. It is a separate legal entity apart from its owners. A corporation is owned by shareholders, and controlled by a board of directors who appoint officers (CEO, President, CFO, etc) to handle the day-to-day operations. C-Corp profits are taxed on the federal and state level and the dividends that stockholders receive are taxed as well (resulting in "double taxation").

S-Corporation (S-Corp): A S-Corporation can be thought of more as a tax status than an actual business entity. In reality all S-Corps are Corporations or Limited Liability Companies that simply meet the criteria needed to be considered an S-Corp for taxation purposes. If a corporation (or LLC) elects to be classified as a S-Corp, the profits of the corporations will not be taxed at the corporate level, but will be passed through to the individual shareholders and taxed at their individual tax rate, avoiding the “double taxation” issue the comes up in C-Corporations. To qualify for the “S election” a corporation must be a domestic corporation, have less than 100 shareholders and have only one class of stock. The shareholders must be individuals, tax exempt organizations or certain allowable trusts. There can be no non-resident alien shareholders. Corporations in certain business sectors, such as insurance companies, cannot qualify as S-Corps. To “elect” the S Corporation status the shareholders must unanimously consent to the election. S Corporations are responsible for taxes on certain built in gains and passive income.

Non-Profit Entity (501(c)(3)): A 501(c)(3) is more commonly referred to as a charitable organization. A charitable organization is generally tax-exempt, relieving it from liability from most federal and state income taxes. “Unrelated business income” can be taxed. To qualify for 501(c)(3) status, an organization must be operated exclusively for the exempt purposes laid out in the Internal Revenue Code. The organization must also ensure that none of its earnings benefit any private shareholder or individual involved in the charity. These organizations are also limited in their political activity; they cannot attempt to influence legislation as a substantial part of its activities and it may not participate in any campaign activity for or against political candidates.

The **exempt purposes** laid out in 501(c)(3) are: charitable, religious, educational, scientific, literary, testing for public safety, fostering national or international amateur sports competition, and preventing cruelty to children or animals. The term *charitable* is used in its generally accepted legal sense and includes relief of the poor, the distressed, or the underprivileged; advancement of religion; advancement of education or science; erecting or maintaining public buildings, monuments, or works; lessening the burdens of government; lessening neighborhood tensions; eliminating prejudice and discrimination; defending human and civil rights secured by law; and combating community deterioration and juvenile delinquency.

10 questions to ask yourself when choosing an entity

1. What type of business are you?
2. How many people are involved?
3. How good at paperwork are you?
4. Does your business have a need for a lot of start up capital?
5. Will you maintain a place of business where customers will come to you?
6. What does your tax situation look like?
7. Is your business a full time job or a part time situation?
8. Will you have employees?
9. How much money are you going to make?
10. Where do you see your business in five years?

The pros and cons of your choice of entity

<u>Type of entity</u>	<u>pros</u>	<u>cons</u>
Sole Proprietorship		
Partnership		
Limited Partnership		
Limited Liability Partnership		
Limited Liability Company		
Corporation (C-Corp)		
S-Corporation		
501(c)(3)		

Online Resources

Colorado Bar Association: go here to find attorneys in Colorado and check to see their specialties, disciplinary backgrounds and other useful information. A good starting point when seeking an attorney to help you start or grow your business.

<http://www.cobar.org/>

Colorado Secretary of State: go here to file the papers necessary to form your business. Filing fees vary for the documents you file, but typically run from \$25 to \$50.

<http://www.sos.state.co.us/>

Internal Revenue Service: the IRS website plays host to a huge array of resources that provide guidance for running your business. Also, go here to establish your business's Tax EID number.

<http://www.irs.gov/>

National Venture Capital Association: provides a wide variety of resources dealing with the venture capital industry and includes a good set of example documents that will be useful if your business gets to the point where it needs venture capital.

<http://www.nvca.org/>