

There are several issues that you should consider when determining the legal structure of your business. First, to what extent will you be personally at financial and legal risk? Second, who will have the controlling interest in the business? Third, how will the business be financed? There are advantages and disadvantages to each legal structure. As a new business entrepreneur, you should examine all the characteristics and determine which is best suited to your needs.

As you decide upon your legal structure, you should carefully evaluate both your present and future needs for operating your business. To avoid duplication of legal expenses, licensing and paperwork, analyze your various options and choose the business structure that will meet your long-term needs rather than choosing a business structure solely for its short-term convenience. While it is not a requirement, it may be valuable to consult an attorney. See the chapter on Choosing Advisors for suggestions on how to select an attorney and other professional advisors.

### Sole Proprietorship

A Sole Proprietorship is a business owned and operated by a single individual. There are few legal requirements to be met to establish a sole proprietorship. If an individual is operating the business under a name other than his/her own full first and last legal names, the business name must be registered as a trade name online with the Secretary of State at [www.sos.state.co.us](http://www.sos.state.co.us). It is the most common form of legal structure for new small businesses.

**Advantages** – It is the least complicated form of legal structure. All profits and losses of the business are reported directly on the owner's personal income tax return. All decision-making and control remains in the hands of the single owner. As a result, the owner is able to respond quickly to business challenges and opportunities.

**Disadvantages** – The primary disadvantage of a sole proprietorship is that the proprietor is personally responsible for all the business liabilities and debts. If the business is unable to meet its financial obligations, creditors may pursue the personal assets of the owner. The sole proprietor is generally lim-

**When you start your business, you must decide what legal structure it will have. There are several choices of business formats in Colorado including sole proprietorship, general partnership, limited partnership, corporation, limited liability company, registered limited liability partnership, registered limited liability limited partnership and limited partnership association.**

ited to financing the business by using his/her own assets and/or borrowing money. Borrowing money will require periodic loan payments regardless of whether the business is making money. Therefore, the fact that the owner's personal assets are at risk is an important factor. If you and your spouse run your business together and share in the profits, your business may be considered a partnership. You should record your respective shares of partnership income or loss separately for self-employment taxes. Doing this may or may not increase your total tax. It will ensure that each spouse receives credit for social security earnings on which retirement benefits are based. IRS Publication #541, "Partnerships," is a useful guide regarding partnership filing requirements and the allocation of income to the partners. Married couples are encouraged to consult a competent tax professional to determine the exact tax implications of their business.

The Colorado Department of Revenue will require that a husband and wife register the business as a general partnership if both are listed as owners of the business for state sales tax and employment taxes.

**NOTE:** The transfer of a business between spouses is considered a change in ownership and is treated in the same manner as the transfer or sale of a business between two unrelated individuals.

### General Partnership

A General Partnership is a business owned by two or more individuals or other business entities. Although it is not required, it is strongly recommended that a general partnership prepare a written partnership agreement that outlines the business' structure and each partner's responsibilities. If the partnership owns real property, the partnership agreement should be filed in the county where the property is located with the office that keeps real estate records. Otherwise, there is no requirement

to file the agreement with any state or federal agency. If the partners are operating the business under a name other than their own legal names, the business name must be registered as a trade name with the Colorado Secretary of State online at [www.sos.state.co.us](http://www.sos.state.co.us).

**Advantages** – Partnerships have few legal requirements for formation. Partnerships are able to pool the financial, professional and managerial talents and resources of two or more individuals. A partnership is financed through the capital contributions of the partners and by borrowing money. The profits and losses of the business are reported annually on federal and state partnership returns. However, there are no partnership taxes. The partners are individually responsible for the taxes on their personal income tax returns. Profits and losses may be divided among the partners in whatever manner determined by the partners.

**Disadvantages** – The partners in a general partnership are personally liable for all business debts. Even if the partnership agreement specifies a defined split in profits, each partner is 100 percent responsible for all liabilities and debts. The personal assets of any one or all of the partners may be attached to cover the partnership's liabilities, regardless of which partner incurred the liability or debt.

### Limited Partnership

A Limited Partnership is a business owned by two or more individuals or other business entities in which at least one of the partners has limited liability protection. There must be at least one general partner who remains personally responsible for all the partnership's liabilities. Limited partnerships are created by filing a "Certificate of Limited Partnership" with the Secretary of State.

**Advantages** – A limited partner's risk is limited to his/her financial - cash or property - investment in the business. The general partner(s) can retain personal control of the

business while increasing the financial resources available to the businesses without incurring long-term debt. A limited partnership may raise capital by selling additional limited partnership interests in the business.

**Disadvantages** – The general partner(s) remain(s) personally responsible for all the liabilities and debts of the business. The limited partner(s) may not work in the business or participate in management without risking loss of limited liability status.

## Corporation

A Corporation is a legal entity that exists separately from the people who create it. A corporation is owned by its shareholders and run by a board of directors elected by the shareholders. In a large corporation, the directors hire corporate officers to manage the day-to-day operations of the business. In a small corporation, the directors and the corporate officers are usually the same individual(s). Corporations are created by filing “Articles of Incorporation” with the Secretary of State and by adopting bylaws. There are certain formalities a corporation must adhere to, including:

- Procedures for annual shareholder meetings
- The election of the board of directors
- Maintenance of corporate records
- Adoption of bylaws
- Complete separation of personal and business finances, and
- Proper filings with the Secretary of State. Although many of the requirements may seem unnecessary for a small corporation, they are important to preserve the corporate form.

**Advantages** – A corporation is a legal entity separate from the owners. It is like a person with a life of its own. This creates a wall of separation that normally limits a stockholder’s liability to the amount of investment in the corporation. If an owner dies or wishes to sell his/her interest, the corporation continues to exist and do business. This adds stability to its existence. Once a corporation has been established through the Secretary of State, no other business may register with the Secretary of State using the same name.

**Disadvantages** – While a corporation limits an owner’s liability, the owner(s) and/or the corporate officers may still be held responsible

## CORPORATE FINANCING

A corporation may raise capital to begin the business by two different means: equity financing and borrowing money. Equity financing involves the issuance of shares of stock, which represent ownership in the business. Stock may be issued in exchange for cash, property, labor or services rendered. The primary advantage of equity financing is that the corporation is not required to repay the principal or interest. Instead, the shareholder acquires an interest in the business and may share in its future profits.

When issuing stock, a corporation should be aware that there are various types or classes of stock. Different classes of stock grant the shareholder different rights when profits are distributed.

A corporation may also acquire capital by borrowing money. Debt financing is attractive to the investor because the corporation is legally obligated to repay the principal and interest. Interest payments are deductible to the corporation. However, debt financing may be difficult or impossible for a new corporation which has little or no current earnings. A loan may require the personal guarantee of the corporate officer(s) who may then be held personally responsible for the repayment of the loan. A shareholder who is a working officer in the corporation is considered to be an employee and must be paid a “reasonable wage” subject to state and federal payroll taxes. If dividends are paid in lieu of wages, the entire dividend is subject to payroll taxes.

if the “corporate veil” has been pierced. The “corporate veil” can be pierced in a number of ways, primarily by the personal actions or guarantee of an owner. Corporate profits may be subject to double taxation. A corporation must pay tax on income as a separate legal entity. If profits are distributed to shareholders, they are also subject to taxation as part of the individual shareholder’s income.

## S Corporation

An S Corporation is not a separate form of legal structure, but rather a special tax status granted by federal tax law to a corporation to tax the business’ income like a partnership or a sole proprietorship. A corporation elects S Corporation status by filing with the IRS on Form 2553, “Election by a Small Business Corporation.” Generally, the election must be filed within 75 days of incorporating. Otherwise, a corporation may not change its status until the beginning of each new calendar year. Form 2553 must be filed by March 15th to be effective for the new tax year. Once elected, S Corporation status will continue until the shareholders revoke the choice or a corporation no longer meets the qualifications.

**Advantages** – An S Corporation has all the general advantages of “regular” corporations

except it does not pay corporate income taxes. It divides the expenses and income among its shareholders. Individual shareholders report profits and losses on their personal income tax returns.

**Disadvantages** – To apply for S Corporation status the business must comply with the following restrictions:

- It must be a domestic corporation. It cannot be a financial institution using the reserve method of accounting for bad debts, an insurance company, a corporation that takes tax credits for doing business in a U.S. possession, or be a domestic international sales corporation (DISC).
- It may only have one class of stock issued and outstanding.
- It may not have accumulated earnings and profits at the close of each three consecutive taxable years if 25 percent of its gross receipts for each of the years are passive investment income. Passive investment income includes royalties, rents, dividends, interest, annuities, and sales or exchanges of stocks or securities.
- It may have a maximum of 75 shareholders. It may not have as a shareholder any person who is not an individual except certain qualifying trusts or certain qualifying exempt

## ARTICLES OF INCORPORATION

*An attorney is not required to file Articles of Incorporation. However, if you decide not to use an attorney, you should educate yourself thoroughly regarding all aspects of a corporation. The following are basic definitions related to filing Articles of Incorporation and should not be considered comprehensive legal advice. For example, common stock and preferred stock are the two classes of stock that a corporation may issue. In addition, stock may have other attributes and combinations of attributes that define a stockholder's rights. Articles of Incorporation may include additional information regarding the management, structure, purpose and goals of the corporation that are not outlined here.*

**Corporation Name** is the name you wish to call your corporation. The name must include the word corporation, company, incorporated or limited or an abbreviation of one of these words. The name may not be the same as any existing corporation. You may check on the name availability by going online at [www.sos.state.co.us](http://www.sos.state.co.us) select business center, then under the business information column you can search business database to see if the name is being used. If it is not being used go to file a document and you are creating a new record. Fill out the form for a profit corporation. When you complete the form online you will be able to submit online with a charge card. The Secretary of State is located at 1700 Broadway, Suite 200, Denver CO 80202, and there phone number is 303-894-2200.

**Cumulative Voting** is the ability of a shareholder to vote the number of shares owned multiplied by the number of directors to be voted on. For example, if shareholder "A" owns 100 shares and three directors are being elected, shareholder "A" has 300 votes to cast for any one director or he can split up the votes and cast any desired number for any one or more of the candidates.

**Duration**, the life of a corporation, is perpetual unless otherwise stated in the Articles of Incorporation. This means that a corporation will exist for an indefinite period of time, potentially forever, unless a specific number of years are stated. Most corporations are perpetual in duration.

**Preemptive Rights** entitle each shareholder the right to maintain the same proportion of ownership if additional stock is issued. If a stockholder owns 25 percent of current outstanding stock, she/he would have the option to purchase 25 percent of new issues before the stock is offered to anyone else.

**Common Stock** normally has the following characteristics:

- The right to vote for the board of directors.
- The right to receive dividends when declared by the board of directors.
- The right to share in the distribution of assets, after creditors and preferred stock, if the corporation is liquidated.

**Preferred Stock** is normally associated with the following characteristics:

- Very limited voting rights.
- Preference over common stockholders for receiving dividends.
- A preference over common stockholders, after creditors, in the distribution of assets if the corporation is liquidated.
- The stock may be repurchased by the corporation at the option of the corporation.

**Authorized Shares** are the total number of shares that the corporation has the authority to issue. If there is more than one class, record the number of shares in each class. The number of authorized shares may only be changed at a later date by a vote of the stockholders as provided in the bylaws.

**Par Value** stock must have a stated value in the Articles of Incorporation. The stock cannot be issued unless par value is paid to the corporation.

**No Par Value (NPV)** stock is issued at a value determined by the board of directors at the time of issue. Generally, the value is determined by whatever price the market will bear when the stock is issued.

**A Registered Agent** may be an individual or another corporation who represents the corporation. Although a post office box may be included, the registered agent must have a physical address on record at all times with the Secretary of State. The address may or may not be the corporation's place of business.

**A Board of Directors** must have one or more members and the number or method of determining the number must be specified in the bylaws. Directors must be at least 18 years of age.

**Incorporators** are the individuals who perform the initial steps of incorporation. They may or may not be involved in the corporation's activities after the formation of the corporation. Incorporators must be at least 18 years of age.

**Bylaws** are the rules by which a corporation is managed and regulated. The bylaws are adopted and amended by the board of directors.



organizations. Shareholders must be U.S. citizens or resident aliens.

- It must have a tax year ending December 31.
- All shareholders must agree to elect S Corporation status.

While an S Corporation is not subject to double taxation as a regular corporation, it loses the ability to deduct the full cost of medical insurance as a business expense under current tax law. Corporate officers are still treated as employees. There are also differences in how business losses are carried forward, which may be positive or negative depending upon the individual situation. A competent tax advisor should be consulted before applying for S Corporation tax status. It is important to note that the corporation must file the “Articles of Incorporation” with the Secretary of State before it can apply to the IRS for S Corporation status. For more specific information about qualifying and applying as an “S” Corporation, contact the IRS, at 600 17th Street, Denver, CO 80202- 2490, 1-800-829-1040.

### Limited Liability Company

The Colorado Limited Liability Company Act was adopted in 1990. An LLC combines the concepts of partnerships for tax purposes and corporations for liability purposes. LLCs are created by filing “Articles of Organization” with the Secretary of State. While similar, LLCs are NOT corporations. In an LLC, the owners are called members. The members may elect or hire a manager(s) to run the business. As in a corporation, the owner(s)/member(s) may elect themselves to be the manager(s).

**Advantages** – Members of an LLC are protected from personal liability in the same way as corporation shareholders, while the entity itself can have the flexibility of a partnership. The IRS has determined that LLCs may elect to be treated as partnerships or corporations for income tax purposes. A Colorado LLC will be treated as a partnership if there are two or more owners, unless the LLC elects to be taxed as a corporation. However, state law allows the formation of an LLC by a single individual. In that case the IRS will treat the LLC as a sole proprietorship. Because LLCs are a new form of legal structure and various questions remain unanswered, it

BUSINESS REGISTRATION		
	Secretary of State	Internal Revenue Service
Sole Proprietorship	●	
General Proprietorship	●	●
Limited Partnership	●	●
Corporation	●	●
Limited Liability Company	●	●
Limited Liability Partnership	●	●
Limited Partnership Association	●	●
Nonprofit Organization	●	●

This table describes business registration requirements only. If you make product, sale or have employees refer to the Sales Tax and Employer Responsibilities chapter of the guide.

[www.sos.state.co.us](http://www.sos.state.co.us)  
[www.irs.gov](http://www.irs.gov)

is recommended that you consult a knowledgeable attorney if considering the formation of an LLC.

**Disadvantages** – LLCs are a recognized legal structure in all states. However, tax and liability treatment of an LLC is not uniform across state lines. There may also be limitations on the transferability of ownership in certain situations. In that case the IRS may treat the LLC as a sole proprietorship or partnership.

### Limited Liability Partnerships & Limited Liability Limited Partnerships

The Limited Liability Limited Partnership Act became law July 1, 1995. The intent of the law is to create a form of legal structure that is similar to S Corporations and Limited Liability Companies. Registered Limited Liability Partnerships (LLP) and Registered Limited Liability Limited Partnerships (LLLLP) limit a partner’s personal liability in the business to their personal investment in the business, except in areas related to their personal professional conduct. LLPs and LLLPs will usually be taxed as partnerships but may elect to be taxed as corporations. Filing a “Registration Statement” with the Colorado Secretary of State creates both entities. The partners in LLPs and LLLPs are directly considered the operators of the business. There is usually no election of officers or managers as in corporations or LLCs.

**Advantages** – New businesses and existing

general partnerships (currently registered with the Colorado Secretary of State) may register as a Registered Limited Liability Partnership. Existing limited partnerships (currently registered with the Colorado Secretary of State) may register as a Registered Limited Liability Limited Partnership and gain liability protection for all partners without a complete reorganization of the business. The liability protection is similar to the protection provided to the owners of a corporation. Once an LLP or LLLP has been registered with the Colorado Secretary of State, no other business may register with the Colorado Secretary of State using the same name. The intent of the law is to gain the benefits of the partnership form of business while limiting the personal liability of the owners.

**Disadvantages** – LLPs are primarily for businesses where all the owners belong to a single licensed profession, e.g. CPAs, attorneys, doctors, etc. It is a new form of legal structure and it is not a recognized form of legal structure in all states. Anyone considering the formation of a LLP or a LLLP should consult a knowledgeable attorney.

### Limited Partnership Associations

The Colorado Limited Partnership Association Act created the new form of legal structure called the Limited Partnership Association (LPA) and became law on July 1, 1995. This new entity is created by filing “Articles of Association” with the Colorado Secretary of State.

**Advantages** – The main difference between a limited partnership association and a partnership or limited liability partnership is that the association has an indefinite life. Its existence terminates upon the affirmative vote of all of its members or as otherwise provided in the bylaws and by filing articles of dissolution with the Colorado Secretary of State. The association's existence does not terminate upon the disassociation, death or bankruptcy of a partner. Under the Act, LLCs may convert to LPAs in the same fashion that they could convert to partnerships or limited partnerships under the Limited Liability Company Act.

**Disadvantages** – LPAs must have two or more persons as members of the business. This structure is very new and at this time there are few interpretive guidelines.

### Nonprofit Organizations

Nonprofit is a term that refers to an organization that uses all profits to further organizational goals instead of distributing the profits to shareholders, organizers or owners. (NOTE: Distribution of wages includes the payment of wages.) In Colorado, an organization may choose to be an Unincorporated Nonprofit Association or a Nonprofit Corporation.

### Association vs. Corporation

Clubs or other less formal groups that do not intend to seek any special tax-exempt status or to exist beyond the current members normally form nonprofit associations. If organized as an unincorporated nonprofit association, a constitution, articles of association or a written declaration of organization must be adopted by two or more persons, and the name must be registered online with the Secretary of State at [www.sos.state.co.us](http://www.sos.state.co.us). To further clarify an association's nonprofit status, additional optional documentation may be filed with the Secretary of State. However, organizations that want to become tax-exempt or exist beyond the current organizers should consider organizing as a Nonprofit Corporation. While not explicitly required, it will be easier to obtain tax-exempt status if organized as a corporation rather than as an association. A Nonprofit Corporation must file articles of incorporation with

### HOW TO DO A NAME SEARCH

To search for all businesses registered in Colorado, it is necessary to do a name search with Secretary of State. The Secretary of State has an online service where you can check to see if a name is being used. Visit the Secretary of State by going to [www.sos.state.co.us](http://www.sos.state.co.us). Then Click on Business Center when the page changes the left hand column will have Search Business Database. The Secretary of State will provide information on trade names, corporations, limited partnerships, limited liability companies, limited liability partnerships or trademarks filed in the State of Colorado. Most forms can be completed and paid for with a credit card online.

the Secretary of State in accordance with the Colorado Nonprofit Corporation Act and file annual reports in order to update the current name and address of its registered agent and its principal office address. Submitting the annual report also maintains the good standing of the entity with the Secretary of State. For the necessary forms to become a Nonprofit Corporation, contact the Secretary of State, 1700 Broadway, Suite 200, Denver, CO 80202, (303) 894-2200, [www.sos.state.co.us](http://www.sos.state.co.us).

### Register to Solicit Contributions

If a nonprofit intends to solicit contributions in Colorado, it must also register for charitable solicitations with the Secretary of State before it begins raising funds, and it must renew the registration annually. This is separate from the requirement to file an annual report with the Business Division of the Secretary of State's office. Be advised that the legal definition of "solicit" is quite broad, so it is generally safe for an organization to assume that if it holds itself out as a nonprofit eligible to receive tax-deductible contributions, it is required to register. It can do so online at [www.sos.state.co.us](http://www.sos.state.co.us) by going to the Licensing Center, Charities and Fundraisers Registration section of the web site. Contact the Secretary of State, Licensing Division, Charitable Solicitations Section, 1700 Broadway, Suite 300, Denver, CO 80290, (303) 894-894-2200 ext. 6487, [charitable@sos.state.co.us](mailto:charitable@sos.state.co.us).

### Tax-Exempt Status

After organizing, submit Form SS-4, Application for Employer Identification Number, to have the Internal Revenue Service (IRS) assign a Federal Employer Identification Number (FEIN) whether there are any employees

or not. The FEIN is the basic federal tax ID number for the organization. Tax-exempt status requires an additional set of forms and paperwork. Tax-exempt status is granted by the Internal Revenue Service (IRS) to nonprofit organizations to determine their status for paying federal income taxes. Forming a nonprofit association or even a non-profit corporation does NOT automatically establish tax-exempt status. In addition, there are three types of tax-exempt benefits, and one does not automatically grant the other. The first step to becoming tax exempt is determining federal tax-exempt status. There are a number of ways under Internal Revenue Code 501(c) by which an organization may qualify for federal tax-exempt status. Generally, only organizations that have received federal tax-exempt status under 501(c)(3) qualify for Colorado sales tax-exempt status. 501(c)(3) status is issued only to religious, charitable, literary or educational organizations, organizations that promote national or international amateur sports competition and organizations for the prevention of cruelty to children or animals. Contributions made to 501(c)(3) organizations are tax deductible to the donor. Other organizations may become tax-exempt under other subsections of 501(c). Publication #557, "Tax-Exempt Status for Your Organization," is a useful IRS publication in determining an organization's tax-exempt status. Organizations that wish to become tax exempt under 501(c)3 must file IRS Package #1023, Application for Recognition of Exemption. Organizations that wish to qualify for all other types of 501(c) nonprofit status should refer to Publication #557 for filing requirements. It may take six months or longer for the IRS to process an application and issue a Letter of Determination estab-

## WHERE TO REGISTER

### Secretary of State

If you are a sole proprietor or general partnership and will be doing business under a name other than your own legal name(s), you must register your trade name(s) with the Colorado Secretary of State online at [www.sos.state.co.us](http://www.sos.state.co.us). Registration of the trade name does not grant exclusive rights to the use of the trade name. Sole proprietors and general partnerships gain exclusive rights to their name through the use of the name over a period of time or by filing a trademark in addition to registering with the Secretary of State. If you want to find out if a name is already being used, visit the Secretary of State's website at [www.sos.state.co.us](http://www.sos.state.co.us). Under "Business Center" you will see "Search Business Database". By searching this database you can find out whether or not a name is currently in use.

If your business will be a Limited Partnership, Limited Liability Company, Corporation, Registered Limited Liability Partnership, Registered Limited Liability Limited Partnership or a Limited Partnership Association, you must file with the Secretary of State, online at [www.sos.state.co.us](http://www.sos.state.co.us). If you do business under an additional name, you must file a "Statement of Trade Name" with the Secretary of State. Corporations, limited partnerships, limited liability companies and limited liability partnerships organized outside Colorado must file for authority to do business in Colorado as a foreign entity. The Secretary of State will not accept paperwork from a business if another business is already using the same name under the same legal structure.

Secretary of State  
1700 Broadway, Suite 200  
Denver, CO 80202  
(303) 894-2200  
[www.sos.state.co.us](http://www.sos.state.co.us)

### Internal Revenue Service

All forms of legal structure, except sole proprietors with no employees, must obtain a Federal Employer Identification Number (FEIN). The FEIN is your federal tax ID number.

You can obtain your FEIN by:

- a) Filing a completed form SS-4 with the IRS EIN Operation unit for your state Philadelphia, PA 19255 & you'll receive your FEIN within four weeks;
- b) Calling Tele-tin, (800) 829-4933 Monday through Friday 8am- 10pm (for your time zone) and you'll receive your FEIN immediately; or

- c) Faxing your SS-4 to FAX-TIN number (215) 516-3990. FAX-TIN is available 24 hours a Day 7 days a week. Be sure to include a cover sheet showing your FAX number and you should receive your FEIN within four business days. The form can be obtained from the IRS, 1-800-829-3676 or through their website [www.irs.gov](http://www.irs.gov) under forms.

Sole proprietorship owners with no employees may use their social security number as a federal tax ID number or may file form SS-4 to receive a FEIN. The SS-4 and many other federal tax forms may be obtained from the IRS website located at [www.irs.gov](http://www.irs.gov)

### Department of Revenue

Registering for a Sales tax License/Employees

If you will have sales and/or employees, you must use form CR0100, "Colorado Business Registration." The CR0100 will open your sales tax license, state wage withholding and unemployment insurance accounts. You can download the form at [www.taxcolorado.com](http://www.taxcolorado.com) or it can be obtained from the Colorado Department of Revenue at (303) 238-3278, or from the SBDC Hotline at (303) 592-5920. Completed forms may be sent by mail to the Colorado Department of Revenue, 1375 Sherman Street, Denver, CO 80261 or delivered in person at one of the local service centers:

- Colorado Springs  
4420 Austin Bluffs Pkwy.
- Denver  
1375 Sherman St. Room 160
- Fort Collins  
1121 W. Prospect Road, Bldg D
- Grand Junction  
222 S. Sixth St., Room 208
- Pueblo  
310 E. Abriendo Ave., Suite A4

Forms are also available through the Colorado Department of Revenue website located at [www.taxcolorado.com](http://www.taxcolorado.com) or call (303) 238-3278. NOTE: Via mail, you will receive confirmation of your accounts in approximately 3-4 weeks. Local service centers will establish accounts while you wait.

lishing federal nonprofit, tax-exempt status. Contact the IRS at:  
 1) 600 17th Street, Denver, CO 80202,  
 2) Call 1 (800) 829-1040 or  
 3) Visit their website at [www.irs.gov](http://www.irs.gov)

After a 501(c)(3) Letter of Determination is received from the IRS, apply to the Colorado Department of Revenue for a sales tax-exemption. A copy of the Letter of Determination, financial statements and documents confirming your organizational structure and function must accompany application Form DR 715. If the Colorado Department of Revenue determines the organization qualifies for Colorado tax-exempt status, a Certification of Exemption authorizing purchases for the organization without state or local sales taxes will be granted. A Letter of Determination from the IRS does not guarantee Colorado tax-exempt status. For additional information, contact the Colorado Department of Revenue, Taxpayer Services Division at (303) 238-7378 or visit [www.taxcolorado.com](http://www.taxcolorado.com).

Some religious, charitable and educational nonprofit tax-exempt organizations may qualify for property-tax exemption. An organization must own real property to take advantage of this exemption. Federal tax-exempt status is not used to determine whether an organization qualifies for the property-tax exemption. Organizations that would like more information should contact the Colorado Department of Local Affairs, Division of Property Taxation at 1313 Sherman, Room 419, Denver, CO 80203, (303) 866-2371.

Although nonprofit tax-exempt organizations may not pay income tax, they must still file tax returns. IRS Form 990 is used for federal income tax returns and DR 112 for state returns. While there are a few exceptions, tax-exempt organizations are still responsible for all payroll taxes and all other employer responsibilities on employees and must collect appropriate sales tax when selling personal tangible products to the public. See the Employer Responsibilities and Sale Tax chapters of this Guide.

#### Private Assistance for Nonprofits

Colorado Non-Profit Association is a statewide “trade association” for non-profits in Colorado. Colorado Non-Profit Association is a diverse group of more than 1,100 nonprofit

members. It provides information programs, publications and group purchasing services. Colorado Non-Profit Association helps charitable and philanthropic nonprofits manage their organizations and resources. It represents the nonprofit sector and serves as a bridge between the public and private sectors. There bookstore sells a number of useful publications including “How to Form Your Own Nonprofit Corporation” and “Fiscal Sponsorship: 6 Ways to Do It Right.” For more information, contact them at 455 Sherman Street #207, Denver, CO 80203, (303) 832- 5710, 1-800-333-6554. Community Resource Center (CRC) helps take start-up groups through the process of forming a nonprofit. CRC provides direct training, consultation and empowerment services to nonprofits, including leadership training for directors. CRC also publishes the “Colorado Grants Guide” and the “Colorado Funding Report.” For more information contact CRC at 655 Broadway, #300, Denver, CO 80203-0426, (303) 623- 1540, visit their website at [www.crcamerica.org](http://www.crcamerica.org), or email [info@crcamerica.org](mailto:info@crcamerica.org)

#### Cooperatives

A cooperative is a legal organization that is formed by a group of individuals and/or businesses that desire to work together for their “cooperative” benefit. A cooperative has two unique characteristics. A cooperative allows a group of separate individuals or individual businesses to join together for a common purpose such as the bulk purchase of materials, for sharing office space or to sell common products. While a cooperative has to cover its costs to stay in business, it can focus its resources on meeting the needs of its user-owners, called members. Business decisions are made on the basis of what is in the overall best interests of the members. Each member maintains his/her status as an individual or individual business and the cooperative becomes a means to realize common business and personal goals.

**NOTE:** A cooperative is not a form of legal structure used to operate a single independent business. In a cooperative, each member generally has only one vote regardless of the amount of equity owned. This one-member, one-vote approach makes cooperatives very democratic. This can be viewed as an advantage or a disadvantage. Wealthy

members can’t buy control and all members have equal say in how the business is conducted. However, it does not take into account the amount of financial and/or time commitments made to the organization. In a non-cooperative business, people usually have voting power that is based solely on their equity investment. A cooperative may organize as an unincorporated association. This is the least formal method for organizing a cooperative. The only government requirement is the registration of a trade name with the Secretary of State online [www.sos.state.co.us](http://www.sos.state.co.us). However, you must also adopt and have available for members a constitution, articles of association or a written declaration of organization.

Most groups, however, organize as a corporation. Organizing as a corporation has three advantages.

- The personal liability of each member for losses suffered by the cooperative is limited to the member’s equity in the cooperative.
- The cooperative exists independently of the original organizers. Transfer of ownership and control is simple. New members purchase a membership or a share of voting stock. When a person is no longer eligible to be a member, the cooperative repurchases that person’s membership interest.
- Organizing as a corporation conveys the image of a solid, long-lasting venture to members and outsiders.

#### Out-of-State Businesses

Any out of state business that will have ongoing business in the State of Colorado must register with the Colorado Secretary of State. Doing business in Colorado is NOT defined by statute but commonly refers to any business with a physical location in Colorado and/or operation that will extend beyond 30 days.

**NOTE:** All wages and income earned from work and operations conducted in the State of Colorado are subject to Colorado income tax regardless of the residency of the individual or the business. Employers must withhold Colorado income tax from employee wages and make the required estimated income tax payments for the business. Refer to the Employer Responsibilities and the Income and Property Tax chapters of this Guide for more information on filing requirements.

## LEGAL STRUCTURE SUMMARY

*When starting your own business, you must carefully choose the appropriate legal structure for your business. You should examine the characteristics of each structure along with the needs and desires you have for your business. All legal structures are set up at the Secretary of State online at the Secretary of State website: [www.sos.state.co.us](http://www.sos.state.co.us).*

**1) Sole Proprietor** – This is a single individual who owns and operates the business. There is no legal separation between the individual and the business. She/he benefits from 100 percent of the profits and is personally responsible for 100 percent of all the debts and liabilities of the business. If you and your spouse run your business together you have the option of registering your business as a sole proprietor or a general partnership. Colorado law allows a husband and wife to register as a sole proprietor when they register their ownership under one legal name only with the Colorado Secretary of State. The law allows the second spouse full responsibility for the business.

**2) Married Couples** – Couples are encouraged to consult a competent tax professional to determine the exact tax implications for themselves and their business. You and your spouse may run your business together and share in the profits. Be aware, though, that your business may be considered a partnership.

**3) General Partnership** – This is very similar to a sole proprietorship except that there are two or more individuals or entities who own the business. A general partnership offers the means for pooling all resources and sharing control of a business. There is relatively little formality required to establish and run the business, and control remains with the partners. However, all partners remain 100 percent responsible for all the debts and liabilities of the business, regardless of any partnership agreement outlining work responsibilities and shares of profit.

**4) Limited Partnership** – This provides the ability to acquire additional capital while avoiding the need to borrow as the general partner(s) maintain(s) control of the day-to-day operations of your business. The general partner(s) is/are 100 percent responsible for all the debts and liabilities of the business. The limited partner's liability does not exceed his/her investment in the business. However, the limited partner may not be involved in the operations or management of the business.

**5) Corporation** – This is a legal entity separate from the owners of the business. There are significant formalities that must be observed to properly operate a corporation. The corporation provides a wall of liability protection between the business and the owners. It has the ability to raise capital by issuing stock. While the limited liability enjoyed by shareholders may appear attractive, most creditors will probably require a personal guarantee as collateral. The corporation must pay its own taxes in addition to the owners, and owners who work in the business are considered employees. A corporation may become an "S" Corporation through application to the IRS. This will eliminate the double taxation of a corporation, but may result in the loss of some tax deductions and reduce flexibility on the handling of business losses. It does NOT eliminate employer responsibilities for corporate officers.

**6) "S" Corporation** – This is not a separate form of legal structure, but rather a special tax status granted by the IRS to a corporation to tax the business' income like a partnership or a sole proprietorship. A corporation elects "S" Corporation status by filing with the IRS on Form 2553, "Election by a Small Business Corporation."

**7) Limited Liability Company** – This combines the benefits of liability protection in a corporation with a more simplified tax structure like a partnership. It is similar to an S Corporation without the IRS restrictions. However, limited liability companies are a relatively new form of business structure.

**8) Limited Liability Partnerships and Limited Liability Limited Partnerships** – These are new forms of legal structure in Colorado since July 1, 1995. They are similar to limited liability companies with principal benefits to all owners who are members of a single licensed profession. Anyone considering the formation of a limited liability partnership or a limited liability limited partnership is strongly encouraged to use an attorney.

**9) Limited Partnership Association** – This is a new form of legal structure in Colorado effective July 1, 1995. This structure is different from a partnership or limited liability partnership in that the association has an indefinite life. Its existence does not terminate upon the disassociation,

death or bankruptcy of any of its partners. For more information about this structure it is strongly recommended that you contact an attorney for specific liability protection.

**10) Nonprofit** – This is a term that refers to an organization that uses all profits to further organizational goals instead of distributing the profits to shareholders, organizers or owners. In Colorado, an organization may choose to be an unincorporated nonprofit association or a nonprofit corporation. Establishing tax-exempt status is a second process that is

completed by filing either Package #1024, "Application for Recognition of Exemption Under Section 501(a)" or #1023, "Application for Recognition of Exemption," with the IRS.

**11) Cooperative** – This is a legal organization that is formed by a group of individuals and/or businesses that desire to work together for their "cooperative" benefit. It allows a group of separate individual businesses to join together for a common purpose such as the bulk purchase of materials, for sharing office space or to sell common products. As you decide upon your legal structure, you should carefully evaluate both your present and future needs for operating your business. To avoid duplication of legal expenses, licensing and paperwork, analyze your various options and choose the business structure that will meet your long term needs rather than choosing a business structure solely for its short-term convenience. While it is not a requirement, it may be valuable to consult an attorney. See the chapter on Choosing Advisors for suggestions on how to select an accountant, attorney and other professional advisors.

