

Legal Structures – short explanation

Basic Structures

Sole Proprietorship

The sole proprietorship is a simple informal structure that is inexpensive to form. It is usually owned by a single person or a marital community. The owner operates the business, is personally liable for all business debts, can freely transfer all or part of the business, and can report profit or loss on personal income tax returns using the Schedule C.

Limited Liability Company (LLC)

The LLC is generally considered advantageous for small businesses because it combines the limited personal liability feature of a corporation with the tax advantage of a partnership or sole proprietorship.

It is important to note that LLCs in South Carolina are automatically dissolved upon the death of any member (owner). This may be avoided by stating in the membership agreement that “The company (LLC) is not dissolved upon the death of any member.”

Term LLCs expire on the selected date. Normally, most businesses would not elect to be a term LLC.

LLCs must indicate whether they will be member-managed or manager-managed.

Multi-member LLCs are encouraged to put in the member agreement an exit plan or buy-out agreement. This is easy to do when the LLC is created, and can be very difficult when a member begins to entertain thoughts of leaving the company.

General Partnership

Partnerships are inexpensive to form. They require an agreement between two or more individuals or entities to jointly own and operate a business. Profit, loss and managerial duties are shared among the partners, and each partner is personally liable for partnership debts.

Partnerships do not pay income tax, but must file an informational return, while individual partners report their share of profits and losses on their personal return. Short term partnerships are also known as joint ventures.

C Corporation (Inc. or Ltd.)

This is a complex business structure with more start-up costs than most other forms. A corporation is a legal entity separate from its owners, who own shares of stock in the company. It can be created for profit or nonprofit purposes, and may be subject to increased licensing fees and more government regulation than other forms. Profits are subject to income tax at both the corporate level and again when distributed to shareholders.

Shareholders are not personally liable for corporate obligations unless corporate formalities have not been observed. Corporate formalities include: issuing stock certificates, holding annual meetings, recording the minutes of the meetings, electing directors or ratifying the status of existing directors. Corporation formation must be assisted by a qualified attorney.

Sub Chapter S Corporation (Inc. or Ltd.)

This structure is identical to the C Corporation in many ways, but offers avoidance of double taxation. If a corporation qualifies for “S” status with the IRS, it is tax like a partnership. This means the corporation is not taxed, but the income flows through to the shareholders who report the income (their share) on their individual returns.

Special Structures

Limited Liability Partnership (LLP)

LLPs are organized to protect individual partners from personal liability for the negligent acts of other partners or employees not under their direct control. LLPs are not recognized by every state and those that do sometimes limit LLPs to organizations that provide a professional service, such as medicine or law, for which each partner is licensed. Partners report their share of profits and losses on their personal tax returns. Check with your Secretary of State’s office to find out which occupations qualify.

Professional Service Corporation (PS)

A PS must be organized for the sole purpose of providing a professional service for which each shareholder is licensed. The advantage here is limited personal liability for shareholders. This option is available to certain professionals, such as doctors, lawyers and accountants. Check with your Secretary of State’s office to find out which occupations qualify.

Limited Partnership (LP)

LPs have complex formation requirements, and require at least one general partner who is fully responsible for partnership obligation and normal business operations. The LP also requires at least one limited partner, often an investor, who is not involved in everyday operations and is shielded from liability for partnership obligations beyond the amount of their investment. LPs do not pay income tax, but must file a return for informational purposes. Partners report their share of profits and losses on their personal returns.

Non-Profit Corporation

These are formed for civic, educational, charitable and religious purposes, and enjoy income-tax exempt status and limited personal liability. Non-profit corporations are managed by a board of directors or trustees. Assets must be transferred to another non-profit group if the corporation is dissolved.