

Types of Business Ownership

Sole Proprietorship

A sole proprietorship is the easiest and simplest form of business ownership. It is owned by one person. There is no distinction between the person and the business. The owner shares in the business's profits and losses. Since the sole proprietor is self-employed, self-employment taxes must be paid. There is no liability protection for the owner. The owner is liable for all debts. If the individual is sued and loses, the business and personal property may be seized to pay obligations. Sole proprietorships do not have perpetuity. If the proprietor sells the business, quits, or dies, the business ceases to exist.

The business does not need to be registered with the state. Servicemarks and trademarks can be registered with the Secretary of State's office if desired. A Federal Employer's Identification Number is not required as long as there are no employees. The business income is taxed at the sole proprietor's individual tax rate. All business income and expenses are reported on the individual's income tax form 1040 schedule C. Estimated income tax payments are required if estimated income in excess of \$200.

Advantages

- Easy to form
- No documents to file with state
- One level of taxation

Disadvantages

- No tax breaks for company benefits
- Unlimited personal exposure
- Liable for all debts incurred
- No perpetuity of business

General Partnership

A general partnership is formed by two or more individuals. Like the sole proprietorship, the partners are not separate from the business. A partnership agreement should be created that states the duties of each partner, who makes the final decision, and how profit and losses will be apportioned. If the partnership does not have an agreement, the Kansas Uniform Partnership Act will automatically govern the partnership. The provisions set forth in this act may not be in the best interest of a particular partnership. Unless provisions have been established, each individual is responsible for all of the partnership's debt. Also, each partner can incur debt on behalf of the business unless other provisions have been made. Each partner shares in the losses and profits of the business. Partnerships do not have perpetuity. When a partner leaves or dies, the business ends.

As with a sole proprietorship, the general partnership does not need to be registered with the Secretary of State's office. The partnership does need a Federal Employer's Identification Number even if there are no employees.

Each partner follows the same income and tax reporting procedures as a sole proprietor. The partnership itself files a Kansas Partnership Return form each year.

Advantages

- Relatively easy to create
- One level of taxation

Disadvantages

- No tax breaks for company benefits
- Liable for debts incurred by each partner
- No perpetuity of business

Limited Partnership

Like the general partnership, each partner is responsible for the partnership's debts and liabilities in a limited partnership unless other provisions have been established. If there is no partnership agreement, the Kansas Revised Uniform Limited Partnership Act is the agreement for the partnership. As with the general partnership, the provisions set forth in this act may not be in the best interest of each partner. Because of this, it is wise to create a partnership agreement. As with general partnerships, there are no tax breaks for company benefits. One main difference between the general partnership and a limited partnership is that the limited partners' risk is reduced to the amount contributed to the partnership.

Under certain circumstances, the IRS business may tax the business as a corporation rather than a limited partnership. The business need to satisfy at least two of the following four areas to be taxed as a partnership rather than a corporation. The business must not have: 1) perpetuity, 2) consolidated management, 3) limited liability, 4) the ability to transfer business interests without compensation. Like the general partnership, a limited partnership ceases when one partner leaves or dies.

While the partnership does not need any special registration, a Limited Partnership Certificate needs to be filed with the Secretary of State's office.

Tax reporting and payment is carried out the same way as a general partnership.

Advantages

- Limited risk to some partners
- Relatively easy to create
- One level of taxation is possible

Disadvantages

- Liable for debts incurred by partners
- Taxed as corporations under certain circumstances
- No tax breaks for company benefits
- No perpetuity of business

Limited Liability Partnership

Limited liability partnerships are similar to other partnerships. One exception, however, is that partners have limited personal liability due to negligence, malpractice, and conduct of partners not under immediate and direct control of a partner. The partnership is not free from liability due to debts or acts of partners under direct control of a partner. A limited liability partnership is designed to help professionals who operate as a partnership and desire the limited liability protection afforded.

Advantages

- Same as partnerships in addition to limited personal liability

Disadvantages

- Same as other partnerships

Corporation

A corporation is a separate legal entity similar to an individual. Articles of incorporation are required to be filed with the state. The name of the business is followed by the word “incorporated” or “inc.” to indicate that it is a corporation. Annual shareholders meetings are required. A corporation is able to buy and sell property, sue and be sued, and protect its owners from liability. The owners, called shareholders, are individuals who own shares of the corporation’s stock. The stock can be owned by one individual or many individuals. Unlike proprietorships and partnerships, the company can pay for benefits rather than the individual. Corporations have perpetuity because if an owner, shareholder, dies, the business does not cease to exist.

There are two types of corporations: C-corporations and S-corporations. The “C” and “S” identify the type of corporation and where it falls in the IRS tax code for corporations. C-corporations must pay tax on its income. In addition, tax must be paid on dividends paid to shareholders in a C-corporation. Because of this, earnings are taxed at two different levels. However, a C-corporation may be able to eliminate one level of taxation if it does not pay dividends or reduces its profit to zero by paying higher to its employees. Also, shareholders cannot deduct business losses. Both C- and S-corporations have to report their estimated income tax if their tax is expected to surpass \$500.

S-corporations are taxed differently than C-corporations. Like partnership, S-corporations are taxed at the individual level. As a result, there is only one level of tax instead of two. However, only certain corporations can be S-corporations. To qualify as an S-corporation, the corporation cannot have over seventy-five shareholders and have only one type of stock. S-corporation shareholders can only be individuals, estates, and certain trusts. Shareholders cannot be non-resident aliens.

Advantages

- Owners liability limited to amount invested
- Company can pay for benefits
- Perpetuity of business
- Ability to buy and sell assets
- S-corporation has one tax level
- Cash can be raised through sale of stock
- One or many owners
- Business is own legal entity

Disadvantages

- More difficult to start than proprietorships and partnerships
- Two tax levels for C-corporations

Limited Liability Company

In 1990, Kansas authorized Limited Liability Companies (LLC) by means of the Kansas Limited Liability Act. The name of the company contains the words “limited liability company” or “LLC” to indicate that it is a limited liability company. A limited liability company combines the tax and management benefits of a partnership and limited liability of a corporation. Like a corporation, articles of organization creating the LLC must be filed with the Secretary of State. The members (owners) of the LLC should create an operating agreement with the rules that the business will operate by. The operating agreement also states the duties and rights of each member. In Kansas, the articles of organization and operating agreement classify the LLC as a partnership or corporation. It should be noted that this classification may be different than the tax classification discussed later.

A limited liability company is a separate legal entity like a corporation. As such, it is capable of buying and selling assets, as well as to sue and be sued. In addition, An LLC is not a perpetual business. A limited liability company either exists for a fixed period of time or until a member leaves, dies, or is prematurely terminated. A limited liability company is also deemed terminated when fifty percent or more of the total interests are exchanged within a twelve month period.

Liability in an LLC differs significantly from that of a partnership. In a general partnership, all members are personally liable for the actions of the business. Limited partnerships require that at least one person be liable. A limited liability company does not require anyone to be personally liable for the actions of the business except for foreign LLCs.

There are two basic rights afforded to LLC members. The first is the right to receive some form of compensation. This right can usually be transferred unless the LLC agreement states otherwise. The right to vote and take part in management is the second right of an LLC. This right is not as easily transferred as the first right.

Unlike a C-corporation, the LLC does not pay taxes in the state of Kansas. In addition, members of an LLC personally accept the profits and losses of the company.

For federal tax purposes, the IRS classifies most LLCs as partnerships. However, there are some exceptions. The business will be automatically classified as a corporation by the IRS if any of the following apply: the business is organized as a corporation, the business is an association, a joint-stock company or joint-stock organization, an insurance company, a bank with a state charter that is federally insured, state owned. Publicly traded, or has certain foreign businesses. The LLC will be taxed as a partnership unless any of the following apply: there is only one member, the business is not domestic, the LLC chooses to be classified as a corporation, or is publicly traded. For state tax purposes, Kansas classifies LLCs under their federal classification. For example, if the LLC is classified as a corporation under federal guidelines, then Kansas taxes it as a corporation also. Limited liability companies can also be tax exempt if they qualify.

Limited liability companies must use accrual accounting methods if any of the following apply: the LLC is classified as a corporation for tax purposes, has a C-corporation as a member, is classified as a tax shelter, is a syndicate, or offers public securities.

If a partnership changes to a limited liability company, some of the debt that the partners are responsible for may be taken over by the LLC. To qualify, however, the member must be the one that loaned the money to the partnership or is the one that is required to make the payments. Other debt that the LLC cannot assume is given to the members of the LLC.

A partnership can be converted to an LLC in several ways. The partnership can transfer its assets to the LLC and distribute interests to the members thereby ending the partnership. Each partner can contribute his/her interest in the partnership to form an LLC. The third way a conversion can be accomplished is by liquidating the partnership and forming an LLC.

As with corporations, LLCs may have company sponsored benefits.

Advantages

- Separate legal entity
- Limited liability for members
- Taxed as partnership under certain circumstances
- Company sponsored benefits
- LLC does not pay taxes in Kansas
- If converting from a partnership, the LLC may assume some of the debt
- Members accept profits from business
- Participate in management of business

Disadvantages

- Taxed as corporation under certain circumstances
- Requires additional paperwork to create
- Members must accept losses
- No perpetuity of business