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Find the right structure for your business

Over the last several years I have had many conversations with current and future business owners concerning the structure of their business. Whether they are starting a business from scratch or thinking about moving their current operation into its own legal entity, these individuals usually want to know what form their business should take from a legal perspective. A company's structure primarily affects two areas: how the business and its owners are taxed, and how much of a shelter exists from a liability standpoint. In either case, I always advise them to seek guidance from their accountant and attorney so they can mitigate these factors as much as possible. Additionally, these professionals can assist the owners in preparing and filing the necessary documents. Regardless, it is helpful to have a basic understanding of each ownership type.

A sole proprietorship is the most basic type of ownership as the business is held in one person's name only. It is the easiest and cheapest to start and many owners begin here for those reasons and because they are unfamiliar with the other forms of organization. Any income (or loss) from the business activities is reported on the individual's personal tax returns. The main downside of this structure is the proprietor has an unlimited amount of legal and financial liability.

The next level up is a partnership meaning there is more than one owner. There are two basic types of partnerships: general and limited. In a general partnership, each of the partners has an unlimited amount of liability for debts. In a limited partnership, the general partners have unlimited liability to debts but the limited partner's exposure is limited to the amount of that person's ownership. There are really no tax benefits as income is still reported as personal income.

A corporation has several benefits as the investors have a limited amount of personal liability. For example, the investor's personal assets are generally protected from suits against the corporation. Additionally, corporations have a perpetual life (not limited to the lifespan of a proprietor) and the ownership can be transferred. Corporations in need of capital also have the advantage of being able to sell stock. *C-corporations* can have an unlimited amount of shareholders but they are subject to what is called double taxation. The C-corp is taxed on its earnings and then the investors are taxed individually on the dividend earnings they receive. *Sub Chapter S, or S-corps*, have a restriction of 35 shareholders but they have the tax benefit of earnings being taxed on the personal level only.

Limited liability companies (LLC) are chartered with the state and are essentially like S-corps with less paperwork. As the name implies, the owners have a limited amount of liability and double taxation is not an issue as earnings are handled in a way similar to a partnership.

Keep in mind that the four structures discussed above have many different nuances. Therefore it is essential that you consult with your attorney and accountant before finalizing your decision because what works best for one company may not be appropriate for the next.

Please feel free to contact me with any questions or comments you may have by email at mdaily@p-s-b.com or by phone at 309-385-4375.



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