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Liability, Strategy Concerns Help Business Owners Pick Structure

By Finance New Mexico

The form a new business should take isn't always obvious. Though many self-employed entrepreneurs begin as sole proprietors, an individual can structure her business in many other ways. The best structure is the one that fits her business's strategy and size and offers the greatest protection from liability and taxes.

Flying Solo

A sole proprietorship, the simplest business form, is logical for many startups or solo professionals, such as consultants, private investigators or freelance writers. In a sole proprietorship, the business is not separate from the owner and his business income and losses are included on his personal tax returns.

A sole proprietor often has little overhead, and personal assets are used in the business. He operates under his own name or creates a "doing business as" moniker. Because the sole proprietor is personally responsible for all his business's debts and liabilities, he might want to incorporate or become a limited liability company to protect his assets.

A sole proprietor rarely has to do more than obtain a business license and gross receipts tax number, but his business type might require registration with licensing authorities.

Choosing Partners

Some solo entrepreneurs evolve into partnerships, LLCs or corporations to limit liability, expand opportunities or attract investors. It takes at least two people to form a partnership, and the arrangement can be general — with each partner's actions binding the entire group — or limited, where the general partner runs the business and the limited partner receives returns but is silent and powerless in business matters.

All gains and losses go directly to individual partners in proportions agreed to in the partnership agreement. Partnerships can be simple arrangements between two or more people, or they can be more formal combinations.

Going Corporate

Both corporations and LLCs offer owners limited protection from business debts and liabilities, and both are autonomous legal entities.

LLC owners are called members. They can run the business or hire managers to run it. A member-managed LLC resembles a partnership; a manager-run LLC mimics a corporation. Most states require an LLC to have an operating agreement that states the organization's membership and management structure. The LLC isn't required to issue membership shares, hold meetings or record decisions but it is advisable to do so to avoid misunderstandings and conflicts.

Oversight is much stricter for corporations; they must register with the state, adopt bylaws, issue shares to equity holders/owners, hold shareholder meetings and file annual reports, among other requirements. Shareholders don't manage the corporation's affairs or bear personal responsibility for the business's obligations; they vote for directors who hire managers to fulfill these tasks.

C corporations pay taxes on the corporation's earnings, and their shareholders are individually taxed on dividends. If the business qualifies, it can elect S corporation status, avoiding corporate taxes and passing losses or gains directly to shareholders. The rules for organizing as an S corporation are strict, however, and not all businesses qualify.

For more information, visit www.FinanceNewMexico.org. Given the complex considerations involved in starting or expanding a business, entrepreneurs should consult a lawyer or accountant when choosing a structure that offers the greatest advantage.

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