Choosing a Form of Ownership

There is no one “best” form of ownership.

The best form of ownership depends on an entrepreneur’s particular situation.

The key to choosing a form of ownership is understanding how each form’s characteristics affect an entrepreneur’s specific business and personal circumstances.

Factors to Consider

- Tax considerations
- Liability exposure
- Start-up capital requirements
- Control
- Managerial ability
- Business goals
- Management succession plans
- Cost of formation
Chapter 3: Forms of Ownership

- Sole Proprietorship
- Partnership
- Corporation
- S Corporation
- Limited Liability Company
- Joint Venture

Forms of Ownership

- Percentage of Businesses
  - Sole Proprietorships: 69.2%
  - Partnerships: 8.2%
  - C Corporations: 7.7%
  - S Corporations: 11.5%
  - LLCs: 3.5%

Data Source: Statistics of Income Bulletin, Internal Revenue Service, October 2006

- Percent of Sales
  - Sole Proprietorships: 4.3%
  - Partnerships: 10.7%
  - C Corporations: 64.4%
  - S Corporations: 16.2%
  - LLCs: 4.5%

Data Source: Statistics of Income Bulletin, Internal Revenue Service, October 2006
Chapter 3: Forms of Ownership

**Advantages of the Sole Proprietorship**
- Simple to create
- Least costly form to begin
- Profit incentive
- Total decision-making authority
- No special legal restrictions
- Easy to discontinue

**Disadvantages of the Sole Proprietorship**
- Unlimited personal liability

Chapter 3: Forms of Ownership

Liability Features of the Basic Forms of Ownership

**Sole Proprietorship**

- **Claims of Sole Proprietor’s Creditors**
  - Sole Proprietor’s Personal Assets

Disadvantages of the Sole Proprietorship

- Unlimited personal liability
- Limited access to capital
- Limited skills and abilities
- Feelings of isolation
- Lack of continuity

Partnership

- An association of two or more people who co-own a business for the purpose of making a profit
- Take the time to create a written partnership agreement!
Chapter 3: Forms of Ownership

Advantages of the Partnership

- Easy to establish
- Complementary skills of partners
- Division of profits
- Larger pool of capital

Disadvantages of the Partnership

- Unlimited liability of at least one partner

Advantages of the Partnership

- Ability to attract limited partners
- Minimal government regulation
- Flexibility
- Taxation
Chapter 3: Forms of Ownership

Types of Partners

- **General partners**
  - Take an active role in managing a business
  - Have unlimited liability for the partnership's debts
  - Every partnership must have at least one general partner

- **Limited partners**
  - Cannot participate in the day-to-day management of a company
  - Have limited liability for the partnership's debts

Liability Features of the Basic Forms of Ownership

Partnership

Claims of Partnership’s Creditors

- General Partner’s Personal Assets
- Partnership’s Assets
- General Partner’s Personal Assets

Disadvantages of the Partnership

- Unlimited liability of at least one partner
- Capital accumulation
- Difficulty in disposing of partnership interest

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Disadvantages of the Partnership

- Lack of continuity
- Potential for personality and authority conflicts
- Partners bound by the law of agency

Limited Partnership

- A partnership composed of at least one general partner and one or more limited partners
- The general partner in a limited partnership is treated exactly as in a general partnership
- The limited partner has limited liability and is treated as an investor in the business

Liability Features of the Basic Forms of Ownership

**Limited Partnership**

- **Claims of Partnership’s Creditors**
  - Partnership’s Assets
  - Limited Partner’s Personal Assets
  - General Partner’s Personal Assets

- **Barrier**
Chapter 3: Forms of Ownership

The Corporation

- A separate legal entity from its owners

Types of corporations:
  - Domestic - a corporation doing business in the state in which it is incorporated
  - Foreign - a corporation chartered in one state and doing business in another state
  - Alien - a corporation formed in another country but doing business in the United States

The Corporation

- Types of corporations:
  - Publicly held - a corporation that has a large number of shareholders and whose stock usually is traded on one of the large stock exchanges
  - Closely held - a corporation in which shares are controlled by a relatively small number of people, often family members, relatives, or friends

Advantages of the Corporation

- Limited liability of the stockholders
Chapter 3: Forms of Ownership

Liability Features of the Basic Forms of Ownership

- **Corporation**
  - Claims of Corporation’s Creditors
  - Corporation’s Assets
  - Shareholder’s Personal Assets
  - Shareholder’s Personal Assets

Advantages of the Corporation

- Limited liability of stockholders
- Ability to attract capital
- Ability to continue indefinitely
- Transferable ownership

Disadvantages of the Corporation

- Cost and time of incorporating
- “Double taxation”
- Potential for diminished managerial incentives
Disadvantages of the Corporation

- Legal requirements and regulatory “red tape”
- Potential loss of control by founder(s)
- Piercing the corporate veil

S Corporation

- No different from any other corporation from a legal perspective
- For tax purposes, however, an S corporation is taxed like a partnership, passing all of its profits (or losses) through to the individual shareholders
- To elect “S” status, all shareholders must consent, and the corporation must file with the IRS within the first 75 days of its tax year

Liability Features of the Basic Forms of Ownership

S-Corporation

Claims of S-Corporation’s Creditors

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<tr>
<th>S-Corporation’s Assets</th>
<th>Shareholder’s Personal Assets</th>
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Barrier

Barrier
**S Corporation**
- Must be a U.S.-based corporation
- No nonresident alien shareholders
- Only one class of common stock
- No more than 100 shareholders (increased from 75)
- No more than 20% of corporate income from passive investment sources
- Corporations and partnerships cannot be shareholders

**Limited Liability Company (LLC)**
- Resembles an S Corporation but is not subject to the same restrictions
- Two documents:
  - Articles of organization
  - Operating agreement

**Limited Liability Company (LLC)**
- An LLC cannot have more than two of these four corporate characteristics:
  - Limited liability
  - Continuity of life
  - Free transferability of interest
  - Centralized management
Limited Liability Company (LLC)

Claims of LLC’s Creditors

Barrier

LLC’s Assets

Barrier

Member’s Personal Assets

Member’s Personal Assets