

DGM 3110 – Corporate Issues – Terms and Definitions 4 – Entities

Business Entity	A legal “person;” has its own tax ID #, can make contracts, can own property, can sue and be sued, etc.
Sole Proprietorship	Lowest and simplest form of doing business; pays all taxes as an individual; has benefits of business ownership through tax deductions; should consider registering a DBA (a business name); no liability shield.
Partnership	Also called “General Partnership;” unless contracted otherwise (“Partnership Agreement”), partners both own and profit from equal shares of the venture; a “pass-through entity” means that the partners each pay their share of taxes individually; should consider getting a DBA; no liability protection – in fact, liability is heightened because each is responsible for the business acts of the others.
Limited Partnership	Like a general partnership above, except “silent” partners can be included that have no real say in company governance, and do not contribute in a significant or consistent manner to day-to-day operations; general partners have all benefits and burdens as in general partnerships, limited partners are usually not liable for the acts of the general partners beyond risk of loss of their contributions to the company; limited partners can be taxed at “unearned income” rates (no self-employment tax) under certain circumstances (i.e. non-spouse). Limited Partner’s interest is likely to be considered a “security” as a passive investment.
LLC	A legal “person” status for businesses; liability shield protects the owners’ and officers’ separate assets; pass-through entity means the income tax liability is passed through to the owners, who will capture the business income as personal income; ownership is via “interests;” can be member-managed or manager-managed (preferred for flexibility; formalities = no co-mingling of funds and present self to world as LLC).
Corporation	The original form of business entity; is a legal “person” with own tax ID number; has liability shield; ownership via “shares” of stock; hierarchy = shareholders, board of directors, officers, management & employees; formalities = no co-mingling, present self to world as “inc”, annual shareholder meeting(s), annual report(s), quarterly tax withholdings, minutes on file.
C-Corp	Default tax structuring for corporations; profits taxed at corporate level AND at personal level; no limit on classes of stock or number of shareholders; shareholders may be entities or trusts.
S-Corp	Tax status via “election” on IRS form; not taxed at corporate

	level; pass-through entity means income is passed through to the individual shareholder(s) and taxed to them; only one class of stock allowed; only 75 shareholders allowed, and must be natural persons. Dividends come out as unearned income, escaping SE tax. Fair market wage (salary) must be drawn by officers and employees who are also shareholders.
FICA tax	Self-employment tax (funds Social Security and Medicaid, etc.). Combines the 7.65% employer share and the 7.65% employee share of SS-related tax burden into a 15.3% tax on the self-employed.
Two types of tax savings for businesses	1) Deductibility of legitimate business expenses (include “depreciation” for assets with long but finite useful lives), also called “expensing” or “write-offs”; 2) For corporation (and sometimes limited partnership) only: unearned income escapes self-employment taxes. (LLC can be taxed as limited partnership.)
Ways LLC can be taxed	Sole proprietorship, partnership, limited partnership (FICA tax reduction), S-Corp (FICA tax reduction).
Derivative Lawsuit	Suit brought against board and/or officers for breach of fiduciary duties of good governance and/or prudence; initiated by shareholders in behalf of the company being run into the ground.
<i>Ultra Vires</i> activity	Business activity outside the scope of the registered purpose of the business; can eliminate liability shield and tax benefits. Broad or general purpose is best, as <i>ultra vires</i> activity can leave a business exposed in nasty ways.
The six forms or structures for doing business are	Sole Proprietorship; Partnership (General), Limited Partnership (LP=can be tax favored), LLC (can be taxed as Sole P, Partnership, Lim. Partnership, S-Corp), S-Corp (dividends are tax-favored), C-Corp (but not for little companies because it’s “double-taxed”)