

Business Plan Workbook #32

Course	Formalizing Your Dream
Topics Addressed	Choosing the Right Legal Structure

Key Points

Choosing the Right Legal Structure

Many entrepreneurs think about starting their business first and then, much later, they think about how they're going to structure it. But, it's important to think about the legal structure of your business very early.

Choosing the right legal structure for your business can protect your personal assets and can save you from paying unnecessary taxes. The sooner you structure your business, the sooner you can take advantage of the benefits.

Types of Business Entities

The most common business structures are:

- Sole proprietorship
- Partnership
- Corporation
- Limited liability company (LLC)

A **sole proprietorship** is a very common, simple structure for a business. This structure gives the owner complete control of all aspects of the business. BUT, it also means that the owner is personally responsible for ALL financial obligations of the business.

A **partnership** is similar to a sole proprietorship, but involves two or more people. The main advantage is profits or losses are reported on the individual partner's income tax returns. The disadvantage is, like in a sole proprietorship, each partner is personally responsible for the financial obligations of the business.

A **corporation** is a legal entity that is separate and distinct from its owners. It is created to handle the responsibilities of the organization. The main advantage of a corporation is that it reduces personal liability, because the owner, or owners of the business are not personally responsible for the financial obligations of the business. The main disadvantages are that forming a corporation is expensive and extensive record-keeping is required.

A **limited liability company, or LLC**, is a hybrid form of partnership that allows owners to gain benefits from both the corporation and partnership forms of business. One main advantage is that this business structure protects owners from personal liability.

There are other, more specialized forms of organizational entities. For instance, you may decide to create a non-profit organization. If you want to learn about these specialized structures, you should seek expert advice.

Factors to Consider

To decide which legal structure is best for your business, you'll need to assess your situation.

First, you'll want to consider legal liability. Is there a lot of risk associated with your business? If so, you may want to consider forming a corporation or a limited liability company, to reduce personal liability and protect your assets.

You'll also want to think about the tax implications of each business format, and what these implications mean for your business. Corporations and LLCs offer certain advantages when it comes to taxation. But do the tax advantages outweigh the costs of record-keeping? And, do they outweigh the initial cost of incorporation?

Then, you should think about flexibility. Is flexibility important to you? Are you used to making all the decisions? If so, a sole proprietorship may be best option.

Finally you'll need to consider the future needs of your business. Do you think you'll sell your business one day? Do you think you'd like to see your children take over? You should be mindful of your future goals when you're deciding on a business structure.

Some Words of Advice

Choosing a legal structure for your business is important.

First, you should get expert advice before you make a decision.

Experts such as lawyers, accountants, and insurance advisors can help you consider all the advantages and disadvantages, as well as your businesses' unique needs.

Second, you should be mindful that the structure of your business may change over time if your needs or the needs of your business change. For example, your business may start as a sole proprietorship or partnership, but evolve into a corporation as it grows and develops.

Related Business Plan Questions

Below, you will see a business plan question related to the topic noted above. If you print this worksheet, you can use the space below the question to write down some initial thoughts and ideas.

When you're ready to start working on your business plan, return to the course, and select "Open My Business Plan".

Q: Describe the kind of legal structure you have chosen for your business. Use this space to explain any decisions you have made regarding the format. For instance: Who will be the legal owners of the business? Will it only be you, or will you have a partner(s)? If you do have a partner(s), how much of the business will each own? You can estimate a percentage (e.g.: 50% me, 50% my partner).