

You've Decided to Start a Business... but Where Do You Really Start?

Perhaps you've heard or seen advertisements recently by companies offering to incorporate your business online without the use of an attorney. Admittedly, the promise of fast and inexpensive business organization is appealing. What these companies don't tell you, however, is that the form of entity that you select is one of the most important business decisions that you will make and carries with it significant liability and tax consequences to you. By the time you realize what those are, it may be too late.

There are a number of forms to choose from, which depend heavily on your ownership and operating structure, revenue streams and liability tolerance. Each of these business structures addresses those factors differently.

A sole proprietorship is the default business form for an individual. It is not a separate legal entity from you; therefore, operating as a sole proprietorship provides no liability protection, exposing you to unlimited liability for the debts of the business. Further, the owner of a sole proprietorship and the entity are the same for tax purposes; thus, income, deductions, gains, losses and credits would be reported on your personal return and you would be responsible for payment of self-employment taxes, as well as quarterly withholdings.

A general partnership is formed whenever two or more individuals engage in a business enterprise for profit as co-owners. No filing with the Pennsylvania Department

of State is required in order to form a general partnership in the Commonwealth. Instead, operating a business with another co-owner will, by default, create a general partnership. Further, although not required by law, a written partnership setting forth the rights, duties and obligations of each of the partners is vital. As with a sole proprietorship, a general partnership offers no liability protection. Consequently, each partner has unlimited liability for the obligations of the partnership as well as the actions of other partners. Moreover, any general partner has the authority to bind the partnership to contracts with third parties and to incur obligations on the partnership's behalf. For federal income tax purposes, a general partnership is not a taxable entity. Instead, the income or losses of the partnership is passed through to the partners and is reported on each partner's own tax return.

Limited partnerships are formed by filing a certificate of limited partnership with the Department of State. At the outset of forming a limited partnership, the partners should enter into a written Limited Partnership agreement to clearly set forth the rights, ownership interests, and obligations of each partner. A limited partnership has both general partners and limited partners. A general partner manages the business affairs of the limited partnership and has unlimited liability for the debts and obligations of the partnership, as well as the acts and omissions of other general partners. Limited partners, on the other hand, may not participate in the management of the partnership, may not conduct business for the partnership and have no authority to contractually bind the partnership. Furthermore, generally speaking, a limited partner does not have personal liability for the debts and obligations of the organization. Instead, a limited partner's liability only extends to the amount of his or her capital contribution plus his or her respective share of undistributed profits to which he or she is

entitled. Unless otherwise elected, a limited partnership is taxed as a general partnership.

Limited liability companies are created by filing a Certificate of Organization with the Department of State. In general, a limited liability company (“LLC”) combines the federal tax advantages of a partnership, while providing its owners, called members, with personal liability protection enjoyed by shareholders of a corporation. It is essential that members of a LLC enter into a written Operating Agreement. LLCs may either be member-managed or manager-managed. If it is member-managed, then its management structure is that of a general partnership where any of the members can bind the organization with his or her action. However, despite having a general partnership management structure, a member of a member-managed LLC still retains personal liability protection. A manager-managed LLC has a management structure similar to a corporation, where a board of managers manages the organization.

If a LLC has at least two members, then, for federal income tax purposes, it will be taxed as a partnership unless otherwise elected. But, in general, if a LLC has only one member, it will be taxed as a “disregarded entity,”

meaning that it will be taxed as a sole proprietorship.

Pennsylvania business corporations are formed by filing Articles of Incorporation with the Department of State. A corporation is a separate and distinct entity from its shareholders. Therefore, shareholders are not personally liable for a corporation’s obligations and debts even if the shareholder participates in managing the company. A corporation is managed by its board of directors, who are elected by the shareholders. At a minimum, bylaws need to be adopted by the corporation to govern the internal operations of the company and, in some cases, a written shareholder agreement should also be entered into. Furthermore, corporations are required to satisfy certain corporate formalities, such as holding annual directors and shareholders meetings. For tax purposes, a corporation is subject to double taxation, both the corporation and the shareholders pay taxes on income received. This is one of the principal drawbacks of a corporation; however, in some circumstances, a corporation can elect to be taxed like a partnership.

Determining which choice is appropriate for your new business involves evaluating many different factors. Should you have questions about which entity type is appropriate for you, please feel free to contact us.

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Jeff counsels the firm’s clients in general corporate matters, including formation and operational issues, shareholder matters, employment issues, mergers and acquisitions, and creditors rights.

In addition to his corporate law work, Jeff assists clients with structuring and implementing their estate plans through drafting wills and trusts, establishing family limited partnerships and formulating business succession plans. Jeff also represents local taxing bodies and governmental agencies with regard to their bankruptcy related matters.

He is an active member of the Allegheny County Bar Association’s Business Law section, as well as that of the Pennsylvania Bar Association. In addition to Pennsylvania, Jeff is licensed to practice in the state of Florida.



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