

“SELECTING THE RIGHT LEGAL STRUCTURE FOR YOUR BUSINESS”

James G. Keys, Jr., Esq.

The most important decision every business owner will ever make is deciding what type of legal structure is best for operating his or her business. Whether you are starting a new business or restructuring an existing business, you will want to be aware of the advantages and disadvantages of the different ways now available to organize your business.

The purpose of this discussion is to present you with a basic level survey of certain tax and non-tax characteristics of selected business entities under Ohio law. The goal is to provide a foundation for deciding the legal structure that is right for your business operations or investment strategies.

This is not intended to cover audit profiles or restrictions on ownership. As always, it is extremely important to include your accountant in these decisions.

The general characteristics of a **sole proprietorship** are:

Pros

1. One owner. Simplest business form;
2. No formal requirements to create or operate this form; No state filing formalities, unless using a fictitious business name (R.C.1329);
3. Not a separate taxpaying entity; Income is reported on the owner's personal tax return. (No double taxation.)
4. Reliable case law exists.

Cons

1. The business is not a separate entity from the owner; Business cannot hold property or incur debt in its own name;
2. Owner has unlimited *personal* liability for all of the *business's* debts;
3. Owner has unlimited *personal* liability for the acts of employees;
4. Owner has unlimited *business* liability for all *personal* debts.
5. No “similar name” protection (unless fictitious name filing under R.C. 1329);
6. No continuity in event of owner's death.
7. This form should usually be avoided.

The general characteristics of a **General Partnership** are:

Pros

1. Must have two or more owners.
2. No formal requirements to create or operate this form.
3. Not a separate taxpaying entity; Income is reported on the owners' personal tax returns; (business files on an informational return with IRS);
4. Basically, a sole proprietorship with two or more owners (vs. just one owner).

Cons

1. All of the owners have unlimited personal liability for all of the business's debts.
2. All of the owners have unlimited personal liability for the acts of all of the other owners;
3. All of the owners have unlimited personal liability for the acts of employees;
4. Each owner's share of the business can be attached by his personal creditors.
5. Exposure to liability is so great in this form that, simply put, it should not be used.

The general characteristics of a **Corporation** are:

Pros

1. May have one or more owners (shareholders).
2. Formally created under state law;
3. All of the owners have limited personal liability for the *business's* debts (but no limit on liability on owner's business interest for *personal* debts);
4. Can elect to be treated as a "conduit" for tax purposes ("subchapter S");
5. Can be formed as a statutory close corporation that operates more like a partnership or LLC.

Cons

1. Regular "C" corp is a separate taxpaying entity, which results in "double taxation";
2. Regular "C" corp is subject to many formal statutory operating rules in order to maintain the statutory "shield" from personal liability (Articles, stock subscription agreements, stock certificates, election of directors, officers, regular meetings and record keeping requirements);
3. Subchapter S election affects only tax scheme, not the cumbersome operating rules;

4. Close Corporation affects only the operating rules, not tax scheme;
5. Must have all three in place (corporation, subchapter S election, close corporation agreement) to operate like an LLC.
6. Usually more costly than LLC to create and maintain, with less protection than LLC.

The general characteristics of an **LLC** are:

Pros

1. Newer business form;
2. May have one or more owners (members); *like S.P. or partnership*, owners have total authority;
3. Formally created under state law; Business name is protected, *like corporation*;
4. Separate entity from owner; *like corporation*, business can hold property and incur debt in its own name;
5. All of the owners have limited *personal* liability for the *business's* debts;
6. *Business* interests of the owners are protected from claims of the owners' *personal* creditors; ("Two-way" liability protection; this advantage is not enjoyed in the corporation)
7. Not a separate taxpaying entity; Income is reported on the owner's personal tax returns; no separate informational return required if just one owner;
8. Relaxed, less burdensome rules governing operation compared to corp; less risk than corp of creditors "piercing the veil" of limited liability;
9. Usually less costly than a corporation to create and maintain; *like S.P. or partnership*, does not require ongoing time and expense of shareholder/director meetings, etc;
10. LLC can now deduct 100% of company funded benefits (2003), e.g. health insurance premiums, medical reimbursement benefits, long term health care premiums, life insurance premiums, business owner's insurance premiums, etc.;
11. LLC combines into one form the best elements from the corporation (limited liability for all of the owners) and the general partnership (absence of formalities, low costs, tax benefits, "two-way" liability protection)

Usually the LLC, rather than the corporation, will present a better choice for the small business owner, mainly because the LLC is a lower cost, simpler alternative to the corporation with added advantages not enjoyed by the corporation.

Other business entities not included in this discussion are:

Limited Partnerships (LP's)
Limited Liability Partnerships (LLP's)
Professional Corporations/Associations (PC's / PA's)
Professional Limited Liability Companies (PLLC's)

For more information, visit www.KeysLaw.com or contact Attorney Keys at jkeys@KeysLaw.com or (513) 349-1678

About The Law Office of J. G. Keys, Jr., LLC

Practice Areas:

Business matters include Business Formation; Business Entity Selection & Restructuring (LLC's vs. sole proprietorship, partnerships, C corps, S corps, etc.) Nonprofits; Construction Law & Independent Contractors; Buy/Sell Agreements Non-compete/Confidentiality Agreements; Revenue Recovery; Arbitration, Mediation & Litigation; Impact of Ohio's Concealed Carry on Employers and Small Business Owners.

Personal matters include Traffic Law (DUI/OVI, etc.); Family & Juvenile Law; Personal Injury, Bodily & Property Damage; Lifestyle Agreements (Cohabitation, Prenuptial, Alternative); Real Estate Purchase/Construction Agreements.

Bio

James G. Keys, Jr., born October 12, 1949, Harrisburg, Pennsylvania; admitted to bar 1976 (*Ohio and Federal*) **Education:** University of Cincinnati (*J.D.*, 1976); The Central State University, Wilberforce, Ohio (*B.S., with honors*, 1971); **Experience:** Former Magistrate/Referee, Court of Common Pleas, Domestic Relations Division, Hamilton County, Ohio; Former Assistant Ohio Attorney General; Former Special Counsel, State of Ohio;

Member: Ohio State Bar Association (*Former Council of Delegates Member*); Cincinnati Bar Association (*Former Board of Trustee Member, Chair Membership Services*); Greater Cincinnati Minority Counsel Program (*Chair*); Black Lawyers of Cincinnati Association; BLAC/CBA Roundtable (*Chair, Business Opportunity Committee*); Board of Visitors, University of Cincinnati College of Law;

Community: Greater Cincinnati African American Chamber of Commerce; South Eastern Butler County Chamber of Commerce; Cincinnati Recreation Commission Foundation (*Chair*); Board of Directors, Wetherington Golf & Country Club (*Legal Services Chair*), West Chester, Ohio;
Publications: "Selecting the Right Business Structure" – SEBC Chamber Voice, June, 2003; "CEO's Launch Greater Cincinnati Minority Counsel Program" – CBA Reports, April, 1999; "Online Law – Jurisdiction" – Small Business News Journal, November, 1997;