

# Missouri Technology Expo 2010

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## A PRIMER ON BUSINESS ENTITIES

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## **OUTLINE**

- Introduction
- Concepts
- Common Types
- Conclusion and Links

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## INTRODUCTION

### What is a “business entity”?

- A separate unit or “person” for most legal purposes, which can hold property and do business in its own name, enter into contracts, and sue or be sued
- Generally created and governed by state law

## **INTRODUCTION**

### **Preliminary Considerations**

- Prospective planning is critical
- Potential problems may occur whether or not the business is successful
- Form should be driven by business plan, goals, and expectations

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## CONCEPTS

### General Advantages and Disadvantages

- Some advantages include: build name and reputation; facilitate investment, management, and transfer; limit personal liability; and possible tax consequences
- Some disadvantages include: greater formality; more paperwork; and possible tax consequences

## CONCEPTS

### Limited Liability

- Limited Liability: Each owner is generally liable only for his or her own investment or personal negligence or guaranties
- Unlimited Liability: Each owner is jointly and severally liable for all debts or judgments

## CONCEPTS

### Taxation

- “Pass-Through Taxation”: Annual net income or losses are “passed through” the entity and attributed to the owners
- “Double Taxation”: Annual net income or losses are taxed at the entity, and any dividends are taxed again to the owners



## CONCEPTS

### Taxation (cont.)

- Example: the business earns net income of \$100,000
- If the entity has pass-through taxation then the owners personally owe \$40,000 in federal and state taxes, leaving \$60,000 left over
- If the entity has double taxation then the entity owes and pays \$40,000 in federal and state taxes, and if it distributes the rest then the owners personally owe and pay another \$24,000 in federal taxes, leaving only \$36,000 left over

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## COMMON TYPES

- Sole Proprietorship / General Partnership (GP)
- Corporation
- Limited Liability Company (LLC)

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## COMMON TYPES

### Sole Proprietorships

- Default rule for an individual
- An entity in name only
- Easiest and most flexible, at least initially
- Riskiest and not feasible, in the long run

## **COMMON TYPES**

### **General Partnerships (GPs)**

- Default rule for more than one person
- Similar to sole proprietorships, but riskier and more complicated

## COMMON TYPES Corporations

- Owners are “shareholders” or “stockholders” (limited liability and rights)
- The shareholders elect a “board of directors” to manage the entity, which appoints and oversees “executive officers” to make day-to-day decisions, sign contracts, etc.
- The entity is created by filing Articles of Incorporation with the Secretary of State; it is also advisable to adopt bylaws and a shareholders agreement
- The most formal but also the most well-defined and recognized entity

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## COMMON TYPES

### Limited Liability Companies (LLCs)

- Owners are “members” (limited liability but limited or expansive rights)
- The members may appoint one or more “managers” to manage the entity
- The entity is created by filing Articles of Organization with the Secretary of State; it is also required to adopt an “Operating Agreement”
- This type of entity is relatively new and, generally speaking, the most flexible (other than transfers)

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## COMMON TYPES

### Taxation of Corporations vs. LLCs

- By default, corporations are “C Corporations” for tax purposes, meaning they are subject to double taxation
- By default, LLCs are “partnerships” for tax purposes, meaning they are subject to pass-through taxation
- Either entity may elect to be an “S Corporation” for tax purposes, in which case it would be subject to special rules similar to pass-through taxation

## CONCLUSION

- There are many options and details with different consequences
- It is better to plan ahead and choose what is most appropriate for your business
- The first thing to do is retain a good attorney and accountant

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## **LINKS**

Some helpful links on choosing and forming a business entity:

MO SOS: <http://www.sos.mo.gov/business/sbac/>

IRS: <http://www.irs.gov/businesses/small/index.html>

SBA: <http://www.sba.gov/smallbusinessplanner/start/chooseastructure/index.html>

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