Choosing the Right Entity for your Business

With the widespread administration of COVID-19 vaccinations happening across parts of the country, many are becoming cautiously optimistic of a return to some semblance of normalcy. Aspiring entrepreneurs are eager to ride the post-pandemic economic growth and use that momentum to help transform their unique and innovative ideas into successful business operations. In this article, we introduce a number of legal entities available to an entrepreneur, and to distill those entities into their most essential characteristics. We hope the information contained herein will be of use to entrepreneurs when selecting the most optimal business entity to begin his or her venture in California.

This article follows a chart format which is designed to create a more user-friendly experience to help spot the similarities and differences between the various entity forms, including the stakeholders involved, protection against personal liability (i.e. limited liability), tax treatment, and what type of businesses each entity is best suited for. The information contained in this article is being presented as a service to the community and is not intended to constitute legal advice.

<table>
<thead>
<tr>
<th>Corporation</th>
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<tbody>
<tr>
<td><strong>A Corporation can be a “C” Corporation or an “S” Corporation</strong></td>
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<td><strong>“C” Corporation</strong></td>
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<tr>
<td><strong>Stakeholders</strong></td>
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<tr>
<td>• Shareholders (equity owners of the corporation; and can be human beings or other entities).</td>
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<tr>
<td>• Board of Directors (elected by shareholders to make important business judgments on behalf of the corporation).</td>
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<td>• Officers (appointed by the board of directors to make day-to-day operational decisions).</td>
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<tr>
<td><strong>Limited Liability</strong></td>
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<tr>
<td>• Shareholders are generally not liable for losses and debts of the business.</td>
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<td>• In situation in which a court “pierces the corporate veil,” shareholders could become liable.</td>
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<tr>
<td><strong>Double Taxation</strong></td>
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<td>• “C” corporation is taxed on its profits first and then shareholders pay taxes on any dividends they receive from such profits. Shareholders who are employees also pay income taxes.</td>
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<tr>
<td>• California annual franchise tax of $800.00.</td>
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<td><strong>Best Suited For:</strong> Single and multiple-owner businesses seeking both limited liability and established procedures for funding.</td>
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<tr>
<td><strong>“S” Corporation</strong></td>
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<tr>
<td>(An “S” corporation is not a distinct legal entity, but a status under federal tax laws. Once an “S” election is made, the “S” corporation will have the following distinct characteristics:</td>
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<td><strong>Stakeholders</strong></td>
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<tr>
<td>• An “S” corporation may not have more than 100 shareholders and cannot be publicly traded.</td>
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<td>• Shareholders must be human beings and must be U.S. citizens.</td>
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<tr>
<td><strong>Pass-Through Taxation</strong></td>
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<td>• Income and losses flow through to the shareholders and the shareholders then pay taxes on the income earned or report losses on their tax returns directly.</td>
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<td><strong>Best Suited For:</strong> Smaller or family businesses seeking pass-through taxation and limited liability.</td>
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</tbody>
</table>
**Limited Liability Company**

**A Limited Liability Company (“LLC”) can be “Member-Managed” or “Manager-Managed”**

**Stakeholders**
- Members (equity owners of an LLC; and can be human beings or other entities).
  - Profits and losses can be allocated among members differently than the members’ ownership percentage in the LLC.
  - Member-Managed LLC is managed by all of the members or by a Managing Member.
  - Any member can legally bind the entire LLC to a contract or business transaction, unless the counterparty knows that such member does not have authority to do so.
- Managers (only if the LLC is Manager-Managed).
  - Sole Manager or a Board of Managers (similar to directors in a corporation).
- Officers (appointed by members (if Member-Managed) or Managers (if Manager-Managed)).

**Limited Liability**
- Members of an LLC are generally not liable for losses and debts of the business.
- In situation in which a court “pierces the corporate veil,” members could become liable.
- Members could also become liable if the members expressly agree to be personally liable.

**Pass-Through Taxation**
- All income and losses of the LLC flow through to the members and the members then pay taxes on the income earned or report losses on their tax returns directly.
- An LLC may elect to be taxed as a corporation and be subject to double taxation (if the members do not want to be taxed directly).
- California franchise tax of $800.00.
- Members are considered to be self-employed and must pay FICA taxes (i.e. social security and Medicare taxes).

**Best Suited For:** Single or multiple-owner businesses seeking pass-through taxation, limited liability and flexible control over the company.

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**Partnership**

**A Partnership can be General Partnership or a Limited Partnership**

**General Partnership**

**Stakeholders**
- Generally, a partnership is an agreement in which two or more people (i.e. partners) combine resources in a business with the intent to make a profit.
- Officers (appointed by the partners).

**No Limitation of Liability**
- Partners are personally liable for the debt of the entire partnership, including debt incurred by actions of other partners.
  - Each partner can be liable for the full amount of debt of the entire partnership.
  - Any partner can bind the entire partnership to a contract or business transaction, unless the counterparty knows that such partner does not have authority to do so.
### Limited Partnership

**Stakeholders**
- Two or more partners, consisting of at least one General Partner and one Limited Partner.
- General Partner is responsible for day-to-day operations.
- Limited Partner contributes financially to business but has limited control over operations.
- Officers (appointed by the General Partner).

**No Limitation of Liability for General Partners; Limited Liability for Limited Partners**
- General Partners are personally liable for the debt of the entire partnership, including debt incurred by actions of other partners.
- Limited Partners are only personally liable to the extent of the Limited Partner’s investment.

**Pass-Through Taxation**
- Same as a General Partnership.
- California franchise tax of $800.00.

**Best Suited For:** Businesses with two or more owners, at least one of whom seeks a passive investment with no participation in day-to-day management.

### Sole Proprietorship

**Stakeholders**
- The owner. No legal distinction between the owner of the business and the business entity.

**No Limitation of Liability**
- Owner is personally liable for the debt of the entire business.

**Pass-Through Taxation**
- The owner simply reports all business income or losses on his or her individual tax return.

**Best Suited For:** Single-owner businesses that do not have tax concerns and for which potential product and/or service liabilities are minimal and insurance is available.