LIST OF COMMON BUSINESS ENTITIES

Selection of the proper entity or format with which to run a business is crucial. Different entities vary according to tax impact, duration of the entity, transferability of interests, and liability of owners. Here is a summary list of the most common entities, as follows:

Sole Proprietorship: When one person operates an unincorporated business. Profits and losses of the business are normally reported on that person's tax return as part of "Schedule C." This includes individuals using an assumed name or "d/b/a" (doing business as), without formation of an entity separate from the individual. The biggest advantage to this format is lack of any expense for formation of the organization, reporting requirements, etc. The biggest disadvantage is **personal liability** of the individual operating the business.

General Partnership: This entity arises when two or more people transact a business together. No specific filing or organization is required. In most cases, each general partner is liable for any and all debts of the partnership. There is no protection against liability.

Limited Partnership: This is a traditional format whereby "limited partners" are allowed to invest, but have no liability beyond the limited partnership investment. Although limited partners can sometimes share in management functions, traditionally most of the management functions would be performed by the General Partner which acts as the cornerstone of the organization. The General Partner remains personally liable for any debts of the limited partnership, while the limited partners are liable only to the extent of their investment. A partnership must file papers with the State to become a limited partnership.

Corporation (C-Corp.): A corporation is formed by filing Articles of Incorporation with the Secretary of State under state law. Obviously, a completely new entity is created, which will have its own taxpayer ID number. A "C-Corp." is the designation used by the IRS to indicate a corporation formed under state law which is taxed as a corporation, i.e., a separate entity filing its own tax return. With extremely few exceptions, shareholders are not liable for corporate debts.

Corporation (S-Corp.): Like a C-Corp., an S-Corp. is a new entity formed under state law. Like a C-Corp., it provides liability protection for shareholders. However, an S-Corp. is taxed essentially as a partnership so that profits and losses are "passed-through" to the shareholders on a pro rata basis. A specific election must be made with the IRS to obtain the S-Corp. status.

The S-Corp. became perhaps the most popular form of entity because it allowed the dual purpose of pass-through of tax attributes and yet prevented personal liability. However, in order to qualify for the S-Corp. status under IRS regulations, the

corporation may not have more than one class of stock, may not have more than 75 shareholders, and there are special restrictions on owning subsidiaries.

Limited Liability Company (LLC): An LLC is a relatively new type of entity formed by one or more persons by filing organizational papers with the Secretary of State. Instead of filing "Articles of Incorporation" like a corporation, "Articles of Organization" are filed to create an LLC. Under current IRS regulations, unless the LLC elects to be taxed as a corporation, the IRS will tax the LLC like a partnership. Under Minnesota LLC law, all owners of the LLC obtain liability protection.

In addition to avoiding some of the ownership restrictions applicable to an S-Corp. described above, the LLC format has many other tax-specific advantages as compared to an S-Corp. These advantages can include the right to allocate income, loss, deductions and other tax items between the owners in a written Operating Agreement, the right to establish a higher tax basis due to liabilities of the owners, and less recognized taxable gain on the distribution of certain appreciated property. While these tax differences can be quite complicated, many accountants or other tax advisors are showing a strong preference for the LLC format as compared to the S-Corp. format.

Limited Liability Partnership (LLP): This is a partnership that has filed a "Statement of Qualification" to elect status as a limited liability partnership. Unlike an LLC which is formed as a new entity more like a corporation, an LLP is formed when an existing partnership makes an election under state law.

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