

Choosing a Business Structure



value-added & alternative agriculture

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OVERVIEW

A business is a legal entity that takes on a set of characteristics and requirements separate from the individuals who form and operate the business. State law determines the legal requirements associated with each form of business. Federal and state law have their own sets of tax requirements, and business owners need to be aware of both sets of laws when choosing a business structure. A list of web sites to assist you in learning more about these structures and requirements is at the end of this fact sheet.

SOLE PROPRIETORSHIP

A sole proprietorship is the simplest of the available business structures. Individuals who wish to form a business as a sole proprietorship may apply to the Internal Revenue Service on-line to obtain an Employer Identification Number (EIN). This number is required in order to open a business checking account in the business' name.

Individuals who wish to reserve a business name so that it is not used by any other business in a given county may do so at the county Register of Deeds office. The individual will be instructed to search the Grantor/Grantee index over the previous five (5) years to make certain that the name has not been previously reserved.

Those who wish to reserve a business name on a state-wide basis may contact the North Carolina Secretary of State's office. An on-line database is available to determine whether or not a business name is already reserved. The requirements for reserving a business name are available on this web site.

Individuals who operate as a sole proprietorship have the opportunity to file a Schedule C or Schedule F as part of their tax return. Any profit from the operation of the business is taxed at the individual's personal tax rate. A loss from the operation is used to offset the taxes due on other income earned.

The biggest drawback to operating as a sole proprietorship is that the business owners are personally liable for any damages or injuries that occur while in the conduct of the

business. This means that the business owner may be putting both personal and real property at risk in the event of a lawsuit. Coverage through appropriate business insurance can help protect the sole proprietor from personal loss. The proprietor should consult an attorney and/or business insurance agent about the best way to protect the business owner's property.

PARTNERSHIP

An unincorporated partnership operates in much the same way as a sole proprietorship with regard to legal and tax liabilities. The partnership must apply to the Internal Revenue Service to obtain an EIN. The partnership will need to open a separate partnership bank account.

Members of the partnership draw up a partnership agreement that identifies each partner in the enterprise, the percentage ownership of each and any specific information that better defines each partner's role, such as a list of job responsibilities or investment participation.

The partnership completes the appropriate schedule, and the division of the profits (or loss) are reported as income (loss) on each partner's individual tax return.

As is the case with a sole proprietorship, the partnership should consult the appropriate legal and insurance professionals to determine the best way to avoid unnecessary legal liabilities resulting from the operation of the business.

LLC AND S-CORPORATION

The laws of the State of North Carolina allow individuals and groups of individuals to establish either an LLC (limited liability corporation, or an LLP – limited liability partnership) or a corporation. Information on the requirements to form an LLC, LLP or corporation is available at the URL for the NC Secretary of State's office, listed in the Resources section.

The LLC, LLP or corporation applies for an EIN with the Internal Revenue Service. The entity may also need to obtain a separate tax ID number from the NC Department of Revenue. The entity also opens a bank account to keep the entity's funds separate from those of the individual shareholders (business owners).

These three business entities offer the business enterprise certain legal and liability protections not available in a sole proprietorship or simple partnership structure.

Tax liabilities for these structures are handled differently than they are for a sole proprietorship or a partnership, and each structure also has reporting requirements that must be filed with the NC Secretary of State's office. There are annual reporting fees associated with filing the required reports.

Under federal tax law, the income from an LLC or LLP may be taxed at the taxpayer's personal tax rate. In order for the officers of a corporation to be taxed at their personal tax rate, they must file a form (Form 2553) with the U.S. Internal Revenue Service requesting their corporation to be treated as an "S-Corporation" for tax purposes. Once this status is granted, the corporation's officers will file the appropriate tax forms, and may then report the S-corporation's profit (or loss) as personal income (loss) on the individual officers' tax returns.

SUMMARY

The information in this fact sheet is designed to be strictly a guide to helping business owners determine the best business structure and tax situation for their business. It is not an effort to provide legal or tax advice, and the individuals are strongly encouraged to discuss these matters with a qualified accountant, attorney and/or business insurance agent.

RESOURCES

Tax information for businesses, along with information on record-keeping and business structures is available at the IRS web site: <http://www.irs.gov/businesses/index.html>

Information on incorporation from the NC Secretary of State's office is at: <http://www.secretary.state.nc.us/Corporations/>

You may also wish to search the web site at: <http://www.sba.gov> for more helpful information.

The Value-Added and Alternative Agriculture Start-up Tool Kit



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