Marino Money Master$
by Marino Associates, Inc.

Business Organization Types

Choosing the type of organizational entity your business will be is a very important decision. It should be made with the advice of an accountant and a business tax savvy attorney.

Sole Proprietorship

Most small businesses start out as sole proprietorships. It is one owner, one person in charge with all responsibility. The government and other entities do not recognize any real difference between a sole proprietorship and its owner. The income and expenses from the business are included on a separate schedule in the owner's personal individual tax return. The net profit of the business is used to calculate self-employment tax which sole proprietors pay in addition to income tax.

Partnership

Two or more people who share ownership of a business are considered partners and need to have a partnership agreement to prevent issues down the road. This agreement should also include an exit strategy for each partner and a buy-sell agreement. The income and expenses from the partnership are reported on a partnership tax return, with each partner receiving a form showing his or her share of the profit or loss. Each partner then reports their share on their personal individual tax return. Each partner's share of net profit of the business is used to calculate self-employment tax which partners pay in addition to income tax.

Corporation

Corporations afford liability protection to a certain extent for each of its shareholders. Normally, the shareholders are not held personally responsible for the liabilities of the corporation as only the corporation's assets may be looked to for restitution. These shareholders have some type of investment in the business in exchange for a percentage of corporate stock ownership. The income and expenses of the corporation are reported on a corporation tax return. Taxes are paid by the corporation. If any dividends are paid to the shareholders, they also pay tax on the dividends - thus the term "double taxation". Shareholders are usually treated as employees of the corporation and they do not pay self-employment tax in addition to income tax.

S Corporation

An S corporation is a corporation that elects to be treated as a partnership for tax purposes. There are certain limitations as to how many and who can be shareholders in an S corporation. The income and expenses of the S corporation are reported on an S corporation tax return. As with a partnership, each shareholder receives a form showing his or her share of the profit and loss and reports their share on their personal individual tax return. Shareholders are usually treated as employees and they do not pay self-employment tax in addition to income tax.

LLC (Limited Liability Company)

Contrary to popular belief, LLCs are not corporations, although they do provide limited liability protection to the members. Not officially recognized by the IRS, LLCs are regulated by the states, and are a hybrid of a partnership and a corporation. Instead of stock, LLC members hold membership interests. The income and expenses of the LLC are reported on a partnership return for the IRS and on a partnership or individual personal tax return depending on each state's requirements. Depending on the type of business, members may pay self-employment tax in addition to income tax.

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