Business Structures

FIN/571 Foundations of Corporate Finance

University of Phoenix

October 1, 2015

**Business Structures**

Selecting the correct structure is a fundamental decision required by all new businesses. Individuals thinking of starting a business must understand the different business structures and the pros and cons that come with each. Based on the needs of the business the advantages and disadvantages need to be weighed to determine which structure is the best fit. This paper will discuss the impacts (both positive and negative) of each business structure.

**Sole Proprietorship**

A sole proprietorship is the structure in which only one person owns the business. In this structure the owner and the company are considered a single entity for both tax and liability purposes.

A significant advantage to sole proprietorship is that they are somewhat simple and considerably more affordable to set up than other structures. In addition, the sole proprietorship also has tax benefits. Taxes are reported by the owner as part of their individual tax return. Taxes are assessed at the personal income rate and not corporate. In many cases the main reason for sole proprietorship is all about ‘being your own boss’. Only this structure allows the individual to make all decisions pertaining to the business and to keep all profits.

Unfortunately, there are some drawbacks to sole proprietorship such as the challenge of raising capital. Financial institutions are hesitant to provide loans when there are limited assets. If capital can be raised the proprietor assumes all of the risk and liability associated with the business. Any debts or lawsuits have to be settled and/or paid by the individual. Sole proprietors must also pay self-employment tax and cannot bequeath their company. The company and the individual are a single entity so if something happens to the owner, the company must be dissolved into the estate.

**General Corporation**

General Corporation is a business structure in which the company is a separate entity. The company is owned or controlled by shareholders.

One of the primary advantages to General Corporation is the availability of capital. There are generally several investors in the corporation making capital easier to raise. This business structure also provides separation for those investing and the company (and it cannot be dissolved when owners die). As individuals, the Shareholders are not responsible for the debt of the company and are only liable to lose the capital that they have invested. The corporation is responsible for paying taxes (C Corporation) however there is also the possibility to form an S corporation which may reduce taxes as corporate taxes are not filed and only Shareholders report.

In order to establish a corporation, investors must file for incorporation and pay ongoing fees to maintain this which can be a disadvantage. The company must also maintain detailed records and provide annual reports which other structures are not required to do. In respect to taxes, corporations are double taxed (the corporation pays based on profits and the shareholders pay based on their dividends). Corporate taxes can be passed along to shareholders in an S corporation scenario to prevent double taxation but additional paperwork is required.

**Partnership**

A partnership is an unincorporated business relationship between two or more people who share responsibility for the company’s profits and losses.

Similar to a sole proprietorship, an advantage of partnerships is that they are relatively easy to initiate. However, if entering into a partnership, it must be decided whether it will be a general or limited partnership. General partners file taxes individually for the company and pay taxes at an individual, not corporate, rate. As there is more than one owner, partners will have increased capital and more resources to share the workload. Limited partnerships place a restriction on the liability that the partner has (only the invested capital) and personal assets are protected.

Partnership does not protect general owners who are fully liable for the debts of the company. Personal assets are not protected (only limited partnerships have this protection) and there are risks associated with the relationships that partners agree to. There can be challenges if partners are not in agreement or if one wants to sell (or dies). The company is only as stable as the relationship of the partners.

**Conclusion**

All business structures have advantages and disadvantages that have to be carefully weighed against the needs of the business. From taxes to management to liability and everything in between, the business structure will influence how the business is run. Choosing the structure that best fits the business can build the foundation for a successful, solid business.

References

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| --- | --- | --- |
| **Content (70%)** | **Possible Points** | **Points Earned:** |
| \*All key elements of the assignment are covered in a substantive way. Major points are stated clearly; are supported by specific details, examples, or analysis: Identify the different business structures. | 2.8 | 2.8 |
| Identify the different business structures. Write a 350 to 700 word explanation of how each business structure might and might not be advantageous. |
| • The paper links theory to relevant examples and uses the vocabulary of the theory correctly. |
| **Organization (15%)** |  |  |
|       The tone is appropriate to the content and assignment. |  |  |
|       The introduction provides a sufficient background on the topic and previews major points. |  |  |
|       Paragraph transitions are present, logical, and maintain the flow throughout the paper. |  |  |
| The conclusion is logical, flows from the body of the paper, and reviews the major points. | 0.6 | 0.6 |
| **Mechanics (15%)** |  |  |
|       The paper—including tables and graphs, headings, title page, and reference page— is consistent with APA formatting guidelines and meets course-level requirements. |  |  |
|       Intellectual property is recognized with in-text citations and a reference page. |  |  |
|       Rules of spelling, grammar, usage, and punctuation are followed. |  |  |
| Sentences are complete, clear, concise, and varied. | 0.6 | 0.5 |
| **Total Points** | 4 | 3.9 |