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Company Formation a Key to Long-Term Success

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When starting your own business, you need much more than just a great idea. How you choose to form your company can be critical to long-term success. There are a variety of considerations when looking to structure your new venture and choose between a sole proprietorship, S-Corp, C-Corp, or LLC. Each option comes with its own pros and cons that must factor into the decision-making process.

Below we outline important issues that should be examined when forming your company and how they impact your choice of company structure.

Cost of Formation/Operation

While the cost of registration is going to be very similar no matter which option you choose, each structure has a different level of cost to form and to maintain. A sole proprietorship is the least expensive and easiest structure to not only form, but also maintain and operate. That makes it the most common choice.

A corporation will cost more to form and operate, but still offers a relatively low startup cost. An LLC is the more expensive option to operate due to the cost of compliance.

While startup and operation costs are important, they cannot be the only factor driving the decision.

Legal Liability

Legal liability is one of the most important issues to consider when choosing a company structure. Your personal liability is dependent upon the structure you choose, so you must evaluate the level of risk associated with the business and the protection each structure provides.

A sole proprietorship does not offer protection against liability, so if the level of risk with the business is determined to be high, this is likely not the best option.

An S-Corp or C-Corp provides much more protection for shareholders, and an LLC offers the highest level of liability protection for the owners, also called members.

Tax Issues

The tax implications of a company structure can be complex, and you need a good understanding of what these are for each option.

A sole proprietorship is not a separate legal entity from the owner, meaning the income earned from the business is passed directly to the owner's personal income tax return. There is not a separate tax return for the business.

Corporations and LLCs are pass through entities, so the income of the business is passed on to the shareholders or members. This also eliminates the separate business income tax.

For a C-Corp, there are taxes at the entity and shareholder level, but for an S-Corp, there are generally no federal income taxes at the entity level.

For S-Corps and LLCs, income is taxed at the shareholder or member level regardless of cash distributions.

Additional Considerations

There are some additional points of differentiation between an S-Corp, C-Corp, or LLC.

- All these options allow companies to offer employee equity awards; however, equity awards must be structured differently for an LLC and can be more complex.
- An S-Corp is restricted to issuance of a single class of stock. They cannot issue preferred stock to shareholders. They are also limited in the number and kind of shareholders. S-Corps can have no more than 100 shareholders and they must be individuals, estates, or qualified trusts.
- An LLC provides more flexibility when it comes to the number of members, and they can issue multiple classes of stock.
- An LLC can be harder to find investors for because of the tax and regulatory issues associated with the structure. You might also have to convert to a corporation down the road if looking to an IPO.

Deciding on your business structure is a highly complex issue. Legal and tax guidance along the way is essential to making the right decision for you and your company.

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