BUSINESS ORGANIZATIONS

Forms of Business Organizations

Missouri presently allows individuals to operate a business under four forms of organizations:

- Sole Proprietorships
- Partnerships
- Corporations
- Limited Liability Companies

Sole Proprietorship

A sole proprietorship is really not an organization but rather ownership and corporation by one individual. Any one person who begins a business without deliberately creating another form automatically begins as a sole proprietorship. No formal creation is necessary, although if a sole proprietorship will be operated under a name other than the proprietor's, the business name should be registered with the Secretary of State.

Partnership

A partnership is a combination of individuals, called partners, who operate a business and share in the profits and losses of the business. Although no formal creation is necessary, individuals who wish to form a partnership should enter into a written agreement, called a Partnership Agreement or Articles of Partnership, which sets out all the terms of the relationship. In addition, the partnership should register its business name with the Secretary of State. Generally, the partners collectively make decisions concerning the partnership.

A **limited partnership** is a special type of partnership. In a limited partnership, the limited partners share in the profits and losses of the business, but they generally do not participate in the management of the limited partnership.

Missouri law also allows for the creation of a **limited liability partnership**, which permits one partner to be shielded from individual joint liability for partnership obligations created by another partner's or person's misconduct. A partner's liability is not limited, however, when the misconduct took place under the supervision or control of the partner. Only liability arising from the misconduct of other partners or persons is covered by this law; the partnership is not relieved from liability for other partnership obligations and individual partners are liable for their own misconduct.

Corporation

A corporation is a more complex arrangement allowing for multiple owners but with centralized management. The owners, called stockholders, elect directors, who in turn elect officers to manage the affairs of the corporation. The individuals who wish to form a corporation, called incorporators, must prepare a formal written document called Articles of Incorporation. This document is then submitted to the Secretary of State for approval. Once approved, the Secretary of State issues a Certificate of Incorporation that authorizes the corporation to act. A corporation is then considered to act as a separate person.

There are two types of special corporations. A **subchapter S corporation** is a regular corporation but is recognized by the Internal Revenue Service as a special corporation afforded a different income tax treatment. The Internal Revenue Service has technical and complex rules concerning subchapter S corporations. Failure by the corporation or any of its shareholders to observe the rules could have significant adverse tax consequences.

Missouri also recognizes **non-profit corporations**. Missouri treats non-profit corporations somewhat differently and the Internal Revenue Service provides for a different income tax treatment for non-profit corporations.

Limited Liability Company

A limited liability company operates much like a partnership but with some of the advantages of a corporation. A formal written document called Articles of Organization must be prepared and submitted to the Secretary of State for approval. The owners, called members, manage the limited liability company unless the members provide in the Articles of Organization for centralized management by a manager, which could consist of more than one person and function much like the board of directors of a corporation.

Selection of a Business Organization

Although the choice of the type of business organization depends upon many factors in addition to those previously discussed, most selections are made for three reasons:

- Liability
- Income Taxes
- Funding

Liability

Liability concerns the extent to which an owner is responsible for the debts and charges against the organization. If an owner has "personal liability," she is totally responsible, and creditors may reach all personal funds of the owner — even if the funds are not invested in or part of the business. If an owner has "limited liability," his responsibility is limited to only the funds that he has invested in the organization. An evaluation of the risks and possible liabilities to be incurred in the operation of the business leads to the selection of the appropriate form of business organization.

A sole proprietor is personally liable for all debts of the business.

Generally, a partner is also personally liable for all the debts of the partnership. However, the liability of a limited partner in a limited partnership is generally limited solely to that person's investment or contribution to the limited partnership. In addition, a limited partnership can obtain limited liability for its general partners by registering as a limited liability partnership.

Unless special circumstances apply, a shareholder's liability is limited solely by the shareholder's investment in the corporation.

Generally, the liability of a member in a limited liability company is limited solely to the member's investment in the limited liability company.

Income Taxes

All income of a sole proprietorship is taxed on the sole proprietor's own personal income tax return at the appropriate individual tax rates.

A partnership must prepare an income tax return but the partnership pays no income taxes itself. The partnership income tax return acts as a conduit of income to the individual partners. The partnership return apportions the income (or loss) among the partners or limited partners. Each partner or limited partner then includes his or her portion of the income (or loss) on his or her personal income tax return.

Since a corporation is considered a separate person, the corporation prepares its own income tax return and pays income tax on its income. Any distribution of income as dividends to the shareholders is also taxed on a shareholder's individual personal income tax return. The income tax rate for the corporation may be very different from the individual personal rate. A subchapter S corporation is treated similarly to a partnership for income tax purposes; however, a limited liability company can elect to be taxed as a corporation, and a single-member limited liability company is generally taxed the same as a sole proprietorship. The income taxation of a non-profit corporation is separate and very complicated.

If a limited liability company complies with technical and complex income tax rules, the income earned by the limited liability company is taxed as the income from a partnership.

Funding

When obtaining funds from third parties, a sole proprietorship is generally limited to borrowing money, usually from a bank.

A partnership can seek additional investment from loans or it can solicit additional partners (or limited liability partners) who may contribute additional funds.

A corporation has more opportunities for seeking investment. It can borrow money, seek additional investors to purchase either common or preferred stock, or issue other corporate securities such as corporate bonds.

A limited liability company can obtain additional funds similar to a partnership.

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