

Formation of Business Entities

Formation of Business Entities – Study Notes

1. Why Form a Business Entity?

Goal	How a Formal Entity Helps
Limited liability	Protects owners' personal assets from business debts and lawsuits.
Tax efficiency	Allows selection of the most advantageous tax regime (pass-through, corporate, hybrid).
Credibility & branding	Formal name, registration, and filings signal permanence to customers, suppliers, and investors.
Continuity	Entity can outlive its founders; ownership can be transferred without dissolving the business.
Access to capital	Easier to issue equity, obtain loans, and attract investors.

2. Common Types of Business Entities (U.S. focus)

Entity	Key Characteristics	Liability	Tax Treatment	Typical Use
Sole Proprietorship	One owner, no separate legal entity.	Unlimited personal liability.	Income reported on owner's personal return (Schedule C).	Small services, freelancers.
General Partnership (GP)	Two or more owners share management.	Unlimited personal liability for all partners.	Pass-through (Form 1065 ? Schedule K-1).	Professional groups, family businesses.
Limited Partnership (LP)	At least one general partner + one limited partner.	General partner: unlimited; limited partner: liability limited to contribution.	Pass-through.	Investors who want passive exposure.

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Entity	Key Characteristics	Liability	Tax Treatment	Typical Use
Limited Liability Partnership (LLP)	Partners enjoy limited liability for each other's actions.	Generally limited to the extent of investment.	Pass-through. Default pass-through; can elect corporate taxation (Form 8832).	Law, accounting, consulting firms. Most small to mid-size businesses seeking flexibility.
Limited Liability Company (LLC)	Hybrid of corporation & partnership.	Members' liability limited to capital contributed.	Double taxation (corporate tax + dividend tax) unless qualified for S-Corp election.	Companies planning to go public, issue multiple classes of stock, or attract VC.
C-Corporation (C-Corp)	Separate legal entity; shareholders own stock.	Shareholder liability limited to investment.	Pass-through (no corporate tax) but subject to strict eligibility rules.	Small to medium firms that meet shareholder limits and want payroll tax savings.
S-Corporation (S-Corp)	Special tax status for qualifying corporations.	Same limited liability as C-Corp.		
Non-profit corporation (501(c)(3) etc.)	Organized for charitable, educational, religious, or scientific purposes.	Limited liability.	Tax-exempt; donations deductible.	Charities, foundations, schools.

3. General Steps to Form a Business Entity

1. Choose the Entity Type

- Evaluate liability, tax, management, and financing needs.
- Consider state-specific advantages (e.g., Delaware C-Corp, Nevada LLC).

2. Select a Business Name

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- Must be distinguishable from existing entities in the state.
- Check trademark availability (USPTO) and domain name availability.

3. Draft & File Formation Documents

- **Sole Proprietorship / GP** – Usually no filing; may need a “Doing Business As” (DBA) registration.
- **LLC** – File *Articles of Organization* (or *Certificate of Formation*).
- **Corporation** – File *Articles of Incorporation* (or *Certificate of Incorporation*).
- **LP / LLP** –