

# BUSINESS FORMATIONS



## *Corporation Items to Consider*

**Corporation** A corporation is a separate legal entity owned by one or more shareholders. Corporate formation requires filing of the Articles of Incorporation with the Secretary of State's Office. The main advantage of incorporating a business is that shareholders are generally insulated from claims against the corporation for business debts and obligations. Thus, a shareholder's risk is limited to the extent of his or her investment. In order to have the advantage of such limited liability, state law requires that corporations observe certain formalities such as shareholders electing a board of directors to manage the corporation, and directors appointing the corporation's officers. Management of a corporation is therefore centralized when compared to other business forms.



**Sub-C Corporation** The main disadvantage of the standard corporation, or "C corporation," is that the IRS treats the corporation as a separate taxable entity, which often results in "double taxation." A C corporation reports its income on a corporation income tax return and is taxed on profits at corporation income tax rates. Profits are taxed before dividends are paid, and then dividends are taxed to shareholders who report such dividends as income. This results in double taxation of any profits paid out as dividends.

**Sub-S Corporation** Corporations who qualify can elect to be taxed as a "S corporation". The principal advantage of an S corporation is the avoidance of double taxation. In much the same manner as a partnership is taxed, an S corporation's income and expenses "flow-through" to the shareholders, and profits are taxed to the shareholders at their individual tax rates. In order to qualify for S corporation status under the Internal Revenue Code, a corporation may have only one class of stock, no more than 75 shareholders, and no shareholders that are nonresident aliens or non-individuals (e.g. another corporation as a shareholder) except for certain estates and trusts.

**Professional Corporation** Professional Corporations are limited by state law to certain professions. A professional corporation is a corporation organized and licensed or certified by the State of Minnesota to render professional services in fields such as medicine, surgery, chiropractic, registered nursing, optometry, psychology, dentistry, pharmacy, podiatric medicine, veterinary medicine, architecture, engineering, surveying, landscape architecture, certified interior design, accountancy, or law. Every director and officer of a professional corporation must be licensed to render professional services of a type the corporation is authorized to render.

**Nonprofit Corporation** A nonprofit corporation must be incorporated under the Minnesota Nonprofit Corporation Act and be formed for a purpose not involving financial gain to its members. A nonprofit corporation cannot pay dividends or other pecuniary remuneration, even indirectly, to its members. These rules restricting financial disbursements to members are loosened for members who are themselves nonprofit organizations or associated with U.S., Minnesota, or local government. Nonprofit corporations are generally exempt from taxation.

**Limited Liability Company (LLC)** Since 1993, Minnesota has authorized the formation of limited liability companies. This business form combines the advantages of a corporation, namely limited liability for members and centralization of management, with the advantages of a partnership, namely flow-through taxation. An LLC may have one or more members. However, an LLC, unlike a corporation, does not have unlimited life or freely transferable ownership interests.

**General Partnership** A general partnership is a business owned by two or more persons who associate to carry on the business as a partnership. All partners share equally in the right and obligation to manage the business; management, therefore, is decentralized. Also, each partner is personally responsible for all debts and obligations of the partnership; this "personal liability" is the main disadvantage of a general partnership. While general partnerships do not require formal documentation or filing, typically a partnership agreement is drafted to govern the distribution of partnership profits/losses and to allocate responsibilities for managing the partnership. An advantage of all forms of partnerships is flow-through taxation. The partnership is not a taxable entity. Instead, partners are taxed on their respective shares of the partnership's profits at their individual tax rates.

**Limited Partnership (LP)** A limited partnership must have at least one general partner and one limited partner. The general partner is personally liable for all of the debts and obligations of the limited partnership. Because of the greater liability risk, the general partner also has the right and responsibility to control and manage the partnership. Conversely, the limited partner has no right to control or manage the partnership, but he or she is only liable to the extent of his or her investment.

**Limited Liability Partnership (LLP) / Limited Liability Limited Partnership (LLLLP)** As of July, 1994, Minnesota joined a handful of

## Types of Business Forms:

- Corporations
- Sub-C Corporations
- Sub-S Corporations
- Professional Corporations
- Nonprofit Corporations
- Limited Liability Company (LLC)
- General Partnership
- Limited Partnership (LP)
- Limited Liability Partnership (LLP)
- Professional Limited Liability Partnership (PLLP)

other states in making limited liability partnerships available as a business form. An LLP offers some of the liability protections enjoyed by shareholders in a corporation, while at the same time offering the benefits of a partnership; namely, flow-through taxation and decentralized management. LLP status shields partners from personal liability arising out of errors, omissions, negligence, incompetence, or malfeasance of other partners, agents, or employees of the partnership. A business seeking LLP status must register annually with the Secretary of State's Office and must, in its business affairs, hold itself out as an LLP. In most circumstances, organizing a limited liability partnership is more beneficial than a general partnership.

Professional Limited Liability Partnership (PLLP) A professional limited liability partnership is essentially the same as a limited liability partnership except that use of the PLLP form is limited to those professions as listed in the Professional Corporations Act (see Professional Corporation above).