Advantages of an LLC

Learn what advantages make the LLC such a popular choice for business owners.

Many new start-ups are structured as limited liability companies (LLCs) which offer key advantages over other business entities. An LLC blends certain positive attributes of a sole proprietorship, partnership, and corporation without some of the drawbacks of these organizations. State laws governing LLCs may vary, but typically LLCs offer five main advantages for new businesses.

Run Your Own Show

Entrepreneurs are self-starters who prefer to chart their own courses. Most states recognize a single member or owner LLC which means that you can be the sole owner of your business. As a single member LLC, you can make your own business decisions without having to consult with and receive approval from other partners in a general partnership or a board of directors in a corporation. Like a sole proprietor, you own, manage, and operate your business, but without the same liability issues of a sole proprietor. If there are two or more owners, you can enter into an operating agreement to spell out your respective roles and obligations and to structure your business in a way that best suits your needs.

Limit Your Personal Liability

An LLC is viewed as a legal entity separate from its individual members or owners. Similar to shareholders of a corporation, an LLC owner is not personally liable for the LLC's debts or legal liabilities. The LLC owner may lose their capital contribution to the business, like shareholders. However, unlike a sole proprietor or general partner, an LLC's legal obligations usually do not put the LLC owner's personal assets, such as a home or individual bank account, at risk. As with other business organizations, you may still be personally liable in some instances, such as when you personally guarantee a business debt or fail to use due care resulting in harm to a third party or a breach of your duties to your LLC.

Avoid Double Taxation and Pass-Through Deduction

Standard corporations typically face the burden of double income taxation. The corporation's profits are taxed as income and shareholders must pay income taxes on any dividends. LLCs receive "pass through" treatment allowing allocated profits to be taxed only once on each member's individual income tax return. Those LLCs which qualify as a partnership or S corporation also may receive similar "pass through" treatment from the IRS.

In addition, as a pass-through business entity owner, LLC owners may be able to deduct 20% of their business income with the 20% pass-through deduction established under the Tax Cuts and Jobs Act. See The 20% Pass-Through Tax Deduction for Business Owners for more information.

Less Administrative Hassles and Paperwork

Establishing and maintaining an LLC is less complex and requires less paperwork than other corporate entities. An LLC registers its existence by filing articles of organization with and paying a fee to the relevant state office, normally the secretary of state. This filing typically spells out the LLC's name, the location of its principal offices, the identity of its members, the planned duration of the business, and any other statutorily-mandated information. Similarly, corporations must file articles of incorporation with the appropriate state division and must abide by other statutory limits and requirements. After filing, corporations must then hold an organizational meeting to elect corporate officers, to determine authorized classes of shares, and to draft and enact bylaws that detail the company's internal management. The board of directors meets regularly to discuss and finalize business strategies, finances, and policies and may call special meetings when emergency action is needed. Corporations are also required to convene an annual shareholders meeting. In addition, corporations typically must file annual reports and pay yearly fees to retain their corporate status. In most states, these meeting and reporting requirements do not apply to LLCs although LLCs often have annual fee and filing obligations.

Flexibility in Sharing Profits

In most cases, business entities distribute profits based on an owner's capital contribution or percentage of ownership interest. In a general partnership, partners normally share profits equally. Corporations possess the discretion to pay dividends based on each stockholder's proportion of ownership interest. However, an LLC's members retain the flexibility to determine how profits are allocated under the terms of their LLC's operating agreement. LLC members are not limited to their proportion of ownership, but may decide to divide up profits in a different manner. For example, one member may agree to take less than her proportional share in profits if another member agrees to put in extra hours and efforts toward the LLC's daily operations. But LLC's may not dole out profits in certain circumstances, such as when this distribution may endanger the LLC's solvency or when the LLC's liabilities are equal to or greater than its assets. Also there are IRS rules about so-called special allocations that come into play that require allocations not based on ownership interest reflect a legitimate economic circumstance as opposed to merely trying to gain a tax advantage for the owners.