LLC vs S Corp vs C Corp: Best Small Business Structure?

The most common business structures are sole proprietorship, partnership, limited liability company (LLC), and corporation. The structure you choose will impact your ability to raise money, your tax bill, and what happens if your business is sued.

In this article, we'll compare these different business structures and discuss what factors to consider when deciding how to form your business.

If you decide to form an LLC or Corporation, an online legal service makes it easy and will take care of filings and paperwork for you.

Business Structure Advantages & Disadvantages

Here is a snapshot of the different business structures you can consider and their key advantages and disadvantages. As you go through the article, we will explain more in detail how these pros and cons come into play.

Business Structure Comparison Table

Business Structure	Advantages	Disadvantages
Sole Proprietorship	Default setup for single owner business which requires little or no paperwork; owner has total control; profits pass through to personal tax return	No separation between business and personal liability; poor vehicle for raising money from investors
General Partnership	Default setup for multi owner business which requires little or no paperwork; owners can divide control as they see fit; business profits pass through to owners' personal tax returns	No separation between business and personal liability; possibility of partner conflicts; poor vehicle for raising money from investors
Limited Partnership	Provides partnership structure but also makes it easier to raise external capital	Limited partners have no control in the management of the business

Business Structure	Advantages	Disadvantages
Limited Liability Company (LLC)	Protection from personal liability; less record keeping than corp; profits and responsibilities can be easily divided among members.	Not appropriate if you want to raise venture capital or investor money. Entire income of LLC members are subject to self-employment tax contributions, which you can avoid with a Corp (Medicare and Social Security)
C Corporation	Protection from personal liability; easy to raise capital; seen as an established entity personal tax returns	Costly to form; double taxation; extensive paperwork requirements
S Corporation	Protection from personal liability; Profits pass through to owners'	Only some companies eligible; more limits on issuing shares

1. How to Form Your Business

Paperworks, licenses, and business permits are required to operate legally. These also vary based on the type of your business, your location, and the regulations that apply in that state. Below are some general guidelines. You can check the specific paper requirements you need for your business by choosing your state.

a. Sole Proprietorship

The sole proprietorship is the most common business structure. It is run by one individual who is responsible for all the operations, assets, and liabilities. The profits of the business pass through to the owner's personal tax return and are taxed at the personal tax rate. If you are providing a product or service to the public, do not have business partners, and have not set up any other legal entity for the business, then you are automatically a sole proprietorship.

This business structure is ideal for low liability businesses, one-person online businesses, freelancers, small businesses that are just a hobby or part-time job for the owner.

To do business as a sole proprietorship, all you need to do is get any required local licenses for your type of business (restaurant or construction permits, zoning or selling permits, etc.). You also need to register your trade name (i.e. Anne's Cupcake) with the county clerk if you're going to do business under a name other than your legal name. Registering a trade name costs around $100 in most states; the cost of local licenses varies pretty widely.

b. General Partnership

A general partnership is similar to a sole proprietorship but with two or more partners running the business together. It's also very easy to start–if two people verbally agree to form a business together, you have a general partnership.
In a general partnership, partners get dual control over operational responsibilities. They also share in the profits, losses, and liabilities of the business. Your partnership agreement specifies how decisions will be shared and how the business will be run. The profits of the business pass through to the owners' personal tax returns and are taxed at their personal tax rates.

As with a sole proprietorship, you need to get local licenses and register your trade name (if applicable).

We also recommend that you take an extra step and formalize your partnership with a written partnership agreement to outline how the business will be run. While this isn't legally required, many businesses fall apart because of disputes among partners, and a written partnership agreement helps you avoid that. You can hire an attorney to draft a partnership agreement, depending on its complexity, or you can create one yourself using a template.

A buy/sell agreement also comes in handy should you decide to expand your pool of partners in the future. It specifies each owner's rights and responsibilities if they exit the business or want to sell their share in the business.

c. Limited Partnership

The key difference between a limited partnership and a general partnership is that a limited partnership has a special class of partners called limited partners. Limited partners invest in the business but do not run or manage it. In limited partnerships, the decision making authority lies with general partners.

It's even more important to have a partnership agreement with a limited partnership to distinguish the rights of general and limited partners. Taxation in a limited partnership is similar to a general partnership..

To form a limited partnership, in addition to obtaining local licenses and registering a trade name (if applicable), you must file a Certificate of Limited Partnership with the state. This costs around $100 to $200 depending on which state you're forming the business in.

d. LLC's

An LLC is a business structure that combines the features of a corporation (in terms of limited liability) and a partnership (in terms of tax efficiencies and business flexibility). The owners of an LLC (called members) aren't personally liable for business debts and obligations. The business itself isn't taxed; the profits pass through to the members' personal tax returns and are taxed at the members' personal tax rates.

LLC's are ideal for small businesses that need liability protections, don't need to raise a lot of money from investors, and want flexibility in how the business is managed and taxed.

In the last decade, many small businesses have chosen to structure themselves as LLC's. An LLC is a bit easier to form than a corporation, but the state filing fees are usually about the same. You must file articles of organization with your state and publish notice of the LLC's formation in a local newspaper.

While not required, it's also a good idea to have an LLC operating agreement which includes percentage of interests, information on profits and losses and member's rights. While it is not required, it is highly recommended as it provides structures for your finances, and sets out regulations for operations. As with any business form, you must obtain local permits and register a trade name if you'll be doing business under a name that is not your official business name. All states now allow single-member LLC's, so a one-person business can form an LLC. An online legal service will help you quickly form an LLC and take care of filing requirements for you.

e. C Corporations

A C Corporation is a business that is owned by shareholders. The company, and not the shareholders who own it, is held liable financially and legally. With a C Corp, the business is taxed when the company makes profits, and could be taxed again when shareholders are given dividends.

This business structure is a good fit for startups that want to go public in the future, businesses that raise a lot of money from outside investors, or businesses where liability is a concern (construction or healthcare companies).

An online legal service will help you quickly form a corporation and take care of filing requirements for you. If you choose to do it yourself, you should visit the secretary of state website in the state where your business will be located to learn more about business formation.

Whether you use a service or do everything yourself, we recommend hiring a lawyer to help you customize corporate documents.

In most states, you will need to do the following to form a corporation:

File Articles of Incorporation
Create bylaws and organizational resolutions that specify the operating rules for the corporation Appoint a board of directors
Issue stock certificates to your initial shareholders (this last step can be complicated because stock certificates must comply with federal securities laws).
Appoint a registered agent to receive formal documents on behalf of your business (particularly important if you have several business locations).

Some lawyers recommend having a founders' agreement (similar to a partnership agreement) to prevent disputes among business owners. In addition, you must register a trade name (if applicable) and obtain local permits as you would need to do with any business form. Almost all states allow one-person corporations, where the business owner serves as officer, director, and shareholder.

f. S Corporations

S Corporations have an advantage over traditional C Corporation in terms of taxation. There's no double taxation with an S Corp. The business itself is not taxed but the shareholders are, provided that they are paid fair market value. Businesses should have fewer than 100 shareholders to organize as an S Corporation.

Formation requirements for S Corporations are similar to a C Corporation.

2. Personal Liability for Business Obligations

Having a business of any type exposes you to liability. Your business can be sued or go into debt. An LLC or Corporation provides personal liability protection for business owners. This means the owners can't be held personally liable if the business is sued or has debts.

In contrast, when you have a partnership or sole proprietorship, there isn't a clear line between the owner and the business, so you can be held personally liable if the business is sued or has debts. This means creditors can come after your personal assets, such as your home, car, or savings accounts, to satisfy a business obligation.

a. Sole Proprietorships

A sole proprietorship, while easy to form and maintain, provides no personal liability protection from the business' debts and legal obligations. This means that creditors of the business can come after your personal assets, such as your car and home, if the business loses a lawsuit or racks up debt. A precaution you can take is to purchase a business liability insurance policy to cushion yourself from risks that may arise due to filed lawsuits and similar claims directly related to your business.

b. General Partnerships

Like sole proprietorships, general partnerships leave you open to personal liability. However, the scope of liability is even broader with a partnership because every partner is fully liable for the business' debts and obligations *and* for the actions of other partners. For example, if you own a spa, and your partner negligently injures a client during a massage, you could potentially be on the hook for that. You cannot use your partnership agreement to avoid liability for the acts of your partners.

c. Limited Partnerships

A limited partnership offers more liability protection than a general partnership because it creates two classes of partners. "General partners" run the business and assume liability for the partnership. "Limited partners" invest in the business but don't participate in its day-to-day management; they are not liable for the partnership's debts and obligations.

d. LLC's

Members of an LLC are shielded from personal liability for the business' debts and obligations. Exceptions to this rule exist in cases of misconduct. Remember, if you take out a business loan and sign a personal guarantee, then creditors can come after your personal assets if the business stops making loan payments.

e. Corporations

As with an LLC, if you form a corporation, you cannot be held personally liable for business debts or legal obligations. The corporation is an entity separate from its owners and can be sued or held accountable apart from its owners. However, in cases of misconduct or negligence (e.g. fraudulent financial activity), the court will "pierce the corporate veil" and hold owners, members, or shareholders of a corporation personally liable for the company's legal obligations.

Again, if you personally guarantee a loan that's taken out on behalf of the corporation, and you default on the loan, creditors can come after your personal assets to satisfy the loan.

3. Taxes

Similar to other aspects of business, your tax situation depends on what kind of business you have and which state you are headquartered in. Sole proprietorships, partnerships, and S Corporations are often call "pass-through entities". This is because the business itself isn't taxed. The profits flow through to the owners' personal tax returns and are taxed at their personal tax rate. In contrast, a C Corporation gets hit with double taxation: once at the company level and again at the owner/shareholder level.

Below is additional information on different tax requirements based on your business structure

a. Sole Proprietorships

Sole proprietorships are pretty attractive from a tax standpoint. The business income and losses pass through to and are reported on your personal income tax return. There is no separate business tax return. This is a plus because business losses can offset personal income from other sources, reducing your overall tax burden. You pay a similar tax rate to what you would if the money came from an employer, but using the Schedule C tax form to pay for self-employment taxes.

b. General Partnerships

General partnerships are similar to sole proprietorships for tax purposes. They are "pass-through" entities, so the partnership's income and expenses are reported on each partner's personal income tax return. Each partner pays taxes on his or her share of the profits as defined in the partnership agreement. General partners must also pay self-employment taxes.

c. Limited Partnerships

Limited partnerships are taxed similarly to general partnerships, except limited partners do not have to pay a self-employment tax because they are not involved in running the business. In addition, some states have an annual tax on limited partnerships, but this generally isn't very high (California's annual tax, one of the highest, is $800).

d. LLCs

After setting up an LLC, if no election is made with the IRS, then income from the LLC will pass through to the owners in the same manner as it does with a sole proprietorship or general partnership. However, LLCs can also elect to be taxed as a C Corp or an S Corp on their federal tax return. Many LLC's elect S Corp tax status so that the business income passes through to their personal tax returns.

Normally, LLC owners must pay a 15.3 % self employment tax on all of the business income (this is how self employed people contribute to medicare and social security). If you elect S Corp status, you can give yourself a reasonable salary from the business income and treat the remaining income as unearned distributions. Distributions are not subject to the self-employment tax, so this will lower your tax bill.

If you're an LLC and want to change your federal tax status, you'll need to fill out the correct paperwork and submit it to the IRS.

e. C Corporations

C Corporations are not as tax friendly as sole proprietorships and partnerships. In fact, a frequent complaint about C corporations is that they subject you to "double taxation." Learn more about double taxation.

Income from a C Corporation is first taxed at the current corporate tax rate of up to 35%. Income that is paid out to owners in the form of salary is then taxed again at the recipient's personal income tax rate. Income that is paid out as dividends to shareholders is also taxed at the current dividend rate (15% for most taxpayers).

f. S Corporations

The advantage of S Corporations from a tax standpoint is that they avoid double taxation. The profits from the business pass through to the individual owners' tax returns. There is no need to file a corporate tax return. To be eligible as an S Corp, you must have no more than 100 shareholders and one class of stock, among others.

4. Record Keeping Requirements

Running a business entails a lot of paperwork and record keeping requirements. In order to stay compliant with state and federal law, it is important to be aware of what documents are needed and the cost, time, and frequency of filing. Sole proprietorships and partnerships require the least amount of paperwork and legwork. Corporations require the most.

a. Sole Proprietorships

A sole proprietorship has very few ongoing requirements. You may have to renew local permits or pass local inspections. Trade name filings are usually good for 5 years.

Although we recommend that you separate business and personal assets, this isn't a legal requirement for sole proprietorships, so accounting can also be simpler for sole proprietorships.

b. Partnerships

Like sole proprietorships, partnerships also carry few if any ongoing formalities, other than renewing local licenses and trade name filings. If your partnership agreement requires certain formalities to keep the partnership active, be sure to do those.

c. LLCs

The ongoing requirements for an LLC are less onerous than corporate formalities. You're not legally required to hold member meetings or issue membership shares, although it may be a good idea to do so. You must file a statement or report with the state every year. If your LLC operating agreement requires other formalities to maintain the business, be sure to do those as well.

d. Corporations

Of all the different business types, corporations require the most paperwork. Even single-person corporations have to comply.

In most states, corporations must hold annual board meetings and shareholder meetings. Most decisions in running the corporation must be made by a formal vote and documented in meeting minutes. You should keep meeting minutes, as well as other documents such as stock ledgers, at your business location. In addition, virtually all states require corporations to submit an annual report. Meeting these requirements can take a significant amount of time if you're not familiar with your state's corporate law. Many corporations hire an attorney or accountant to take care of the paperwork and compliance matters.

5. Raising Money

If you plan to raise money for your business, then you should choose a business structure that facilitates investment. The best business structure for raising money is a corporation because you have the ability to raise funds through sale of stock. Investors and banks are less likely to put money in or loan money to a sole proprietorship or general partnership.

a. Sole Proprietorships

In general, a sole proprietorship is not ideal for raising money. Since business successes and failures are tied to one owner, sole proprietorships are riskier investment opportunities, and investors tend to shy away from them. If you want to remain the sole owner, you cannot incentivize investors by selling a stake in the business.

Banks also hesitate to provide loans to sole proprietorships because of the perceived continuity risks of a one-person shop (e.g. what happens if the owner becomes ill?). Moreover, since a sole proprietorship is not an entity apart from the owner, you cannot borrow money under the business' name. You must rely on personal funds or take out a consumer loan.

b. General Partnerships

General partnerships are also not well suited for raising money. You cannot attract an investor by selling a stake in the partnership because that would make the investor a general partner. He or she would have to assume liability for the partnership, even if they don't participate in its daily operation. Most investors don't want to take on that kind of liability.

c. Limited Partnerships

Limited partnerships find it easier to raise money because the owners can sell a stake in the partnership to investors. Investors can serve as "silent" limited partners without assuming liability for the business or partaking in daily business operations. Limited partners generally can't lose more money than they invest in the business.

d. LLCs

It's relatively easy to raise money as an LLC because you can sell membership interests to investors. However, investors generally prefer stock to LLC membership because the latter could increase their tax bill. This could happen when the business has an active trade in other states which could subject them to pay taxes there. Also, investors like corporations because a public offering of stock can be their "big pay off." An LLC can't go public; they are privately held businesses, so their return on investment potential is lower.

e. Corporations

It is easiest for a corporation to raise money because it can issue stock. Investors can get a piece of the pie without facing liability for the corporation's mistakes. C Corporations are better situated for raising money than S Corporations because C Corporations allow multiple classes of stock and have no limit on the number of shareholders (S Corporations are limited to to 100 shareholders).

C Corporations are required if you're planning on investing your retirement money in your own business, a process called a rollover for business startups.

Banks are more likely to lend to corporations than to sole proprietorships or partnerships because multiple layers of corporate formalities spread out decision making responsibility and reduce risk.

6. Flexibility

While most businesses stick to their chosen business structure, there are times when various factors would require you to change into a new one that would be more beneficial for your business. This is something you should take into consideration, especially when your business is rapidly growing. It can be expensive and time consuming to switch business structures, so try to choose a structure now that can adapt with your business in the future.

a. Sole Proprietorships

Sole proprietorships are quite flexible. You have complete control over management decisions without having to answer to partners, directors, or shareholders. You can work as much or as little as you want. In addition, you can easily sell a sole proprietorship if you decide that you no longer want to run the business.

b. Partnerships

Partnerships can be flexible, but just how much depends on your partnership agreement. In the absence of an agreement, one partner can freely make decisions on behalf of other partners without their consent. However, partnerships can also be dissolved easily. If the partnership agreement doesn't define the rules for dissolution, a partnership can be dissolved when one partner gives notice that he or she wants to end the business.

c. LLCs

Many small businesses choose to operate as LLCs precisely because of the flexibility that they offer. The operating agreement allows you to specify how much authority different members have in the management of the business.

An LLC can be managed by members or by elected managers. These are managers elected by members or investors to take charge of running the company. If an LLC is manager-managed, the members don't have direct control in the company's governance.

You can also choose for your LLC to be taxed as a partnership or a corporation. In many cases, choosing to be taxed as an S Corp gives you the benefits of operational flexibility and a lower tax burden. You can either choose to observe corporate formalities or ignore them.

d. Corporations

Because of all the formalities that corporations must adhere to, they are not very flexible. As mentioned above, most management decisions must be approved by the board in a formal meeting. Even closing down a corporation requires a formal vote, and dissolution forms and/or tax clearances must be filed with the state. A one-person corporation is more flexible since one person serves as officer, shareholder, and director.

Bottom Line: Best Business Structure

We hope this article gave you a better idea on which direction to take your business. Choosing the right business structure for your business means seeing all the sides of the square – consider setup procedure and costs, formalities, personal liabilities, ease of raising money, tax advantages and flexibility – and choosing which one best fits your business needs. Weigh the pros and cons of the different business structures based on these aspects, and consult a lawyer as necessary.