

Forms of Business Ownerships, A Lay Person's Guide

The following article is part of a presentation that I have given to students on the different legal forms of business ownership.

We have often heard that America's economy was built on the foundation of small business and entrepreneurship. Many people come to America with dreams of owning their own business and becoming rich through their hard work, ingenuity and self-determination. Most businesses start small. Those that are successful gradually grow into the large corporations that dominate the American marketplace today.

We use words like business, enterprise and entrepreneur but what do they really mean?

Definitions

A business is an employment, occupation, profession, or commercial activity engaged in for gain or livelihood; it is *an exchange of goods, services, or knowledge for money*.

An enterprise (one of the definitions) is the willingness to undertake new or risky projects.

An entrepreneur is a person who organizes and manages a business undertaking, assumes the risks for the sake of profit. It is the person who has an idea on how to make money in a business and is willing to spend the time, money, effort, and take the risks necessary to make it successful.

Rules of Business

The first rule of business for a successful entrepreneur is:

$$\text{REVENUES} - \text{COSTS} = \text{PROFITS}$$

(The business must be profitable.)

The second rule to remember is: **CASH IS KING.**

(The business needs cash flow to pay its bills.)

Forms of Business Ownership

There are three major categories of business ownerships.

1. Sole Proprietorship is a form of business in which *one person* owns all the assets of the business in contrast to a partnership and corporation. The sole proprietor is solely *liable for all the debts* of the business (*unlimited liability*).
2. Partnership is a voluntary contract between *two or more competent persons* to place their money, effects, labor, and skill, or some or all of them, in lawful commerce or business, with the understanding that there shall be a proportional sharing of the profits and losses between them. It is an association of two or more persons to carry on, as co-owners, a business for profit. [Uniform Partnership Act, Section 6(1)]. Nearly all states have adopted the Uniform Partnership Act.

Partnerships are treated as a conduit and are, therefore, not subject to taxation. The various items of partnership income, gains, and losses, etc. flow through to the individual partners and are reported on their personal income tax returns.

There are two main types of partnerships:

A. General Partnership is where each person in the partnership has the right to manage and run the business, and can sign contracts and obligate the partnership. Everyone in the partnership has *unlimited liability* for all actions taken by the other partners of the partnership.

B. Limited Partnership – the general partner manages and runs the business of the partnership and has unlimited liability; the limited partners invest money into the business, they do not run the business, and therefore their liability is limited to the amount of their investment in the partnership.

3. Corporation *is an artificial person or legal entity* created by or under the authority of the laws of the state or nation. The day-to-day operations of the corporation are managed by officers who report to the company's board of directors. Members of the board of directors are elected by the shareholders (i.e., the owners) whose interest they represent. The corporation can either exist for either a limited duration of time, or it can exist indefinitely until terminated by law or the shareholders' vote.

Types of Artificial Person or Legal Entity

- A. General Corporation
- B. S Corporation
- C. Limited Liability Company (LLC)