PANNONE
LOPES
DEVEREAUX &
WEST LLC

counselors at law

Business Structures Advantages and Disadvantages of Common Business Structures

A corporate entity structure offers a variety of benefits that are not available in a sole proprietorship or general partnership which include limited liability, perpetual existence and board governance. Despite the benefit of incorporation, it is oftentimes the case that the additional formalities together with tax and regulatory requirements become a difficult hurdle for the owner of a small business. In addition to the corporate structure and general partnership form of enterprise, the limited liability company is becoming a popular form of doing business in many jurisdictions in that it offers several of the benefits of the traditional corporate form while being more flexible and easier to manage in smaller settings. Below you will find a primer on the various forms of entities that are available in Rhode Island in which to conduct business.

1. Close Corporation

The close corporation is a statutory creature and is one of the variations of a general corporate structure in which the shareholders, directors and officers are usually the same individuals and the formality of a board of directors is not required. The shareholders typically manage a Close Corporation and the number of shareholders is limited to thirty. A limitation in using this structure is that transfers of stock are generally more restricted and this is not the form of entity in which the founders will raise equity. Most jurisdictions require that shareholders in a Close Corporation must offer their stock to the other shareholders before transferring it to a third party. Close Corporations are much less formal than those forms of entities in which a board of directors is elected by the shareholders. The Close Corporation resembles a partnership as it relates to governance matters.

Advantages:
1. Limited Liability
2. Less formality
3. Distinct Legal Entity 4.
Perpetual Existence

Disadvantages:
1. Number of shareholders limited
2. Restrictions on raising capital
3. Restrictions on transfer and sale

2. S Corporation

A Subchapter S Corporation is a corporate form of business in which a special tax status has been elected under the Internal Revenue Code. Unlike a C Corporation, the S Corporation has pass through tax treatment and is therefore not subject to double taxation. All other corporate attributes of an S Corporation exist, including limited liability for its shareholders. The IRS does not tax the corporate profits of an S Corporation in that the income of the corporation is taxed directly to the shareholders in accordance with their pro rata interest in the outstanding capital shares of the corporation. The S Corporation is subject to additional limitations that do not apply to a C Corporation. For example, an S Corporation is limited to one hundred (100) shareholders and may only issue one class of stock.

Advantages:
1. Single taxation
2. Limited Liability
3. Distinct Legal Entity 4. Perpetual Existence

Disadvantages:
1. Limited to 100 shareholders
2. One class of stock
3. More difficult to create

3. Limited Liability Company

A relatively new form of business enterprise is called a limited liability company. The limited liability company is created by statute and is similar in treatment to the S Corporation with fewer restrictions. The limited liability form of enterprise is not a corporation; however, it is created in a similar manner with the filing of articles of organization. The owners of a limited liability company are called members and its management is vested in its members. The relationship by and among members is governed by the terms of an operating agreement and by statute in the absence of an operating agreement. A limited liability company does not have a board of directors.

Advantages:
1. Limited Liability
2. Increased Flexibility
3. Member managed
4. No dual taxation
5. No limit on number of members
6. No ownership restrictions of corporations

Disadvantages:

The formation of a new business entity requires the consideration of business, tax and governance issues in order to achieve the goals of its owners.

This outline is not a complete analysis and may not be relied upon as legal advice. Please contact Gary R. Pannone, Esquire for further consultation at 401-824-5115 or send an email to him at gpannone@pldw.com