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# Structuring a New Business in Kentucky

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Starting a small business requires determination, motivation, and know-how. Careful planning and thoughtful preparation from the beginning can determine whether a new business will succeed or fail.

Creating a business plan is a wise first step for anyone embarking on a new business venture. A business plan helps gain a better understanding of the industry structures, the competitive landscape, and the capital required to start a small business. Research shows that organizations with a business plan generate 50% more profit. Capitalization is another key component for start-ups. Lack of adequate funding is the death knell of many small business ventures.

The next step involves identifying the best legal structure for your new venture. Deciding on a business structure is not a decision to be taken lightly. The legal structure of a business affects the liability exposure its owners, the ability to raise capital, and the tax liability of the business.

Kentucky law recognizes a number of different legal structures through which a business can operate. These include sole proprietorships, partnerships, corporations, and limited liability companies. There are several factors to be considered when determining a legal structure for a new business – the type of business, the owners, and the financial structure.

A sole proprietorship is the most basic, and most common, business structure. It is a single person operating a business. A sole proprietorship has no separate legal existence from its owner. Profits of a sole proprietorship are taxed as personal income (at a rate that is generally lower than the corporate tax rate). Because there is no separate legal distinction between the owner and the business, the owner has unlimited personal responsibility for the debts, obligations, and liabilities of the business.

A partnership is like a sole proprietorship in that it has no separate legal existence. It is defined as an association of two or more individuals transacting business for profit as co-owners. There are two types of partnerships – general and limited. In a general partnership, all the partners are actively engaged in the business. In contrast, in a limited partnership there are two classes of partners: general and limited. General partners are active in running the day-to-day operations of the business, while the limited partners have a passive role in the business. Oftentimes, the sole obligation of the limited partners is to provide capital for the business operations. Because a partnership involves the collaboration of two or more people, the owners should consider entering into a partnership agreement that sets forth their respective rights and responsibilities. If such an agreement is well-crafted, it will minimize disagreements and misunderstandings among the partners.

Corporations are the most complex business form. A corporation has an existence separate and apart from its owners. Its owners (known as "shareholders") own stock in the corporation. One of the attributes that makes the corporation a desirable business structure is the ability of the business to sell stock in the corporation to raise capital. Additionally, because a corporation is a separate legal entity, its owners are shielded from personal liability for the debts and obligations of the corporation. The major drawback to operating a business through a corporation is that, in general, the profits of the business are taxed twice. The corporation pays tax on its profits and then the stockholders pay tax on the distributions they receive from the corporation. Corporations are also somewhat rigid in form, and there are many formalities that must be met to maintain the separate legal existence of the entity.

The limited liability company (LLC) is a hybrid form that combines the attributes of a partnership and a corporation. Like a corporation, a LLC is a stand-alone legal entity that is separate and apart from its owners. Therefore, owners of a LLC (called "members") enjoy protection against personal liability for the debts and obligations of the business. However, LLCs can elect to be treated as a partnership for tax purposes. Electing partnership tax treatment eliminates taxation of profits at the business level. Taxes are only paid on distributions paid to the LLC's members. Additionally, LLCs are not subject to the rigid requirements that corporations must meet, making it a much more flexible form.

For many small businesses, sole proprietorships and partnerships are adequate business structures. However, if the business exposes the owners to the risk of significant liability or the owners need to raise capital to start or maintain the business, corporations and LLCs are more appropriate. It takes a solid understanding of the operations of the proposed business, the needs and goals of the owners, and the available legal forms to determine which structure is best suited to a business venture.

There are many factors that impact the decision of how to structure a new business. Thoughtful consideration of many various aspects of operating a business, including the most advantageous legal form, can greatly increase the chance of long-term success.