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## Business Entity Selection

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Q. I am planning to start a small business next year. Do I need to consult with an attorney before establishing a corporation? What kind of corporation do you recommend that I form?

A. Congratulations on your decision to become an entrepreneur! There are several ways in which you might be able to structure your business. Possible options include: sole proprietorship, partnership, limited liability company (LLC), or corporation. Some of the factors that will need to be considered when choosing a business structure include: the number and identities of owners; the type of business (e.g., type of services or products); whether the business will have employees; and how the business will be capitalized.

If, operating alone, you do not affirmatively select a business structure, your business will, by default, be a sole proprietorship. If, operating with one or more persons (other than your spouse), you do not affirmatively select a business structure, your business will, by default, be a general partnership.

Sole proprietorships and general partnerships do not shield their owners from personal liability for debts and obligations of the business. In the case of partnerships, each partner has the legal ability to incur obligations for which each other partner may be personally liable. Thus, in many instances, it probably is not a good idea to operate a business as a sole proprietorship for more than a short period of time. In almost all instances, it probably is not a good idea to operate a business as a general partnership for any period of time.

Businesses may, however, be structured in a manner which will provide its owners with limited

liability in certain circumstances, as well as provide its owners with certain other advantages. The business entity which traditionally has been used to obtain these benefits is the corporation. More recently, Limited Liability Companies (LLCs) have been available as an alternative to the corporation.

LLCs have become popular with some businesses because LLCs typically offer more operational flexibility than corporations, and also because they reduce the amount of certain day-to-day record keeping formalities required of corporations. There are, however, some restrictions on the type of business that can be operated through an LLC. For example, some states do not allow certain professionals to conduct business through an LLC. Professionals may, however, be able to structure their practices as professional corporations, limited liability partnerships, or similar entities.

Sources of funding for your new business should also be considered. Although beyond the scope of this article, a determination must be made regarding whether the method used to capitalize your business will subject the business to various federal and state securities laws.

Finally, as with other business decisions, tax law and consequences should be considered when selecting a structure for your business. Although corporations and LLCs are created pursuant to state law, tax law, at least in the first instance, is governed by federal law. For example, if your business is structured as a corporation, a determination should be made regarding whether the corporation is eligible for classification, for federal tax purposes, as an "S corporation" and, if it is eligible for such

classification, whether the business should elect to be taxed in this manner, rather than as a “C corporation.”

Although it certainly is lawful for you to start a business without the assistance of a lawyer, doing so likely is imprudent. As a business owner and entrepreneur, you need not personally possess all the knowledge and skills necessary to make your business successful; however, you should recognize the need for – and obtain – the assistance of professionals who do possess the needed knowledge and skills.

Earle Law Offices provides trial and appellate litigation, as well as non-litigation, legal services in the areas of bankruptcy, business law, constitutional and civil rights law, family law, real estate law, tax law, and trusts and estates.

\* Mr. Earle is licensed to practice law in all California state trial and appellate courts, the United States Supreme Court, the United States Court of Appeals for the Fourth and Ninth Circuits, federal trial courts in the Northern District of California, and the United States Tax Court. He has served as a Judge Pro Tempore for the Santa Clara Superior Court, and is also a licensed Real Estate Broker.

Mr. Earle received his law degree from the Santa Clara University School of Law, where he served as an Editor of the school’s Law Review, and where he received awards for academic excellence. He received his undergraduate degree, with honors, in business administration from the University of La Verne.

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