CHOOSING A BUSINESS STRUCTURE: SOLE PROPRIETOR, LLC OR CORPORATION

What each structure means for your personal protection, your taxes and your ability to raise money.

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AT A GLANCE

- Your **business structure** decides who's responsible for the business's debts, how it's taxed and who can invest.
- Most main-street businesses start as an **LLC**. Tech startups planning to raise from investors usually form a **corporation**, often a Delaware C corporation.
- You can change structures later, but it costs time and money. Choose with your next 2 to 3 years in mind.

WATCH OUT

This is general education about US business structures, not legal or tax advice. Talk to a lawyer and an accountant before you form your business. Rules differ by state and country.

Why it matters

The wrong structure can leave your home and savings exposed to business debts or lawsuits, cost you more in taxes, or make it hard for investors to put money in. The right one protects you and fits your plans.

The main options

	Sole proprietor	LLC	S corporation (tax choice)	C corporation
Setup	Nothing to file in many places, beyond local licenses	File with your state	An LLC or corporation that elects S status with the IRS	File with your state
Protects personal assets?	No	Generally yes	Generally yes	Generally yes
How profits are taxed	On your personal return	On owners' personal returns by default	On owners' personal returns, with payroll for owners who work in it	Company pays corporate tax, then owners pay tax on dividends
Can sell shares to investors?	No	Possible, but many investors avoid it	Limited: owner and share rules apply	Yes, the standard for venture investors
Paperwork	Least	Moderate	More, including payroll	Most
Often used by	Very small side businesses	Most main-street businesses	Profitable small businesses	Tech startups raising investment

> KEY POINT
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> An **S corporation** isn't a separate kind of company. It's a tax choice an LLC or corporation can make. It can lower self-employment taxes for some profitable owners, but it adds payroll and rules. Ask an accountant whether it fits.

How to choose

1. **Will you raise money from investors who buy shares?** If yes, and especially for a tech startup, a C corporation is usually expected. See **R-11 Venture Capital: How It Works and Whether It Fits**.
2. **Do you want to protect personal assets?** If yes, form an LLC or corporation instead of staying a sole proprietor.
3. **Are you profitable enough to care about tax savings?** Ask an accountant about the S corporation election.
4. **How many owners?** Multiple owners need a written agreement either way. See **B-10 Co-Founder Agreements: Splitting Ownership Fairly** and **B-11 Operating Agreements and Bylaws Explained**.
5. **Where will you form it?** Usually your home state for an LLC. Tech startups often use Delaware.

> EXAMPLE
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> **Rosa** (cleaning company) formed a single-member LLC in her state. It protects her personal assets and keeps taxes simple. **Sofia** (scheduling app) formed a Delaware C corporation before raising money from angel investors, because her investors required it.

Protection isn't automatic

An LLC or corporation only protects you if you treat it as separate:

- Keep business and personal money apart. See **M-03 Keeping Business and Personal Money Separate**.

- Sign contracts in the business's name.
- Keep the business in good standing with the state.
- Many lenders and landlords still ask for a **personal guarantee**, which makes you personally responsible for that debt anyway.

Common mistakes

- **Staying a sole proprietor too long** once you have real customers and risk.
- **Forming an LLC for a startup that plans to raise venture money.** Converting later costs money.
- **Forming in another state just because it's "cheaper."** You may still have to register and pay fees in your home state.
- **Skipping the operating agreement or bylaws.**

Your checklist

☐ Decide whether you'll raise money from share-buying investors
☐ List the owners and how ownership will be split
☐ Talk to a lawyer or a free small business center about structure
☐ Ask an accountant about taxes, including the S corporation option
☐ Choose your structure and state

Key words, explained

Word	What it means
Sole proprietor	A one-owner business that isn't legally separate from the owner.
LLC	Limited liability company: protects owners' personal assets.
Corporation	A company owned by shareholders, separate from its owners.
S corporation	A tax choice that passes profits to owners and can reduce self-employment tax.
Pass-through taxation	Profits are taxed on owners' personal returns, not at the company.

Where to go next

- **B-02 Registering Your Business, Step by Step**
- **B-11 Operating Agreements and Bylaws Explained**
- **M-12 Paying Yourself as a Founder**

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