CLIENT NEWSLETTER

BUSINESS FORMS IN UTAH

A publication of: Robert A. Youngberg, Attorney & Counselor at Law, PLLC. Part of our ongoing effort to keep our valued clients and friends informed of important legal matters that affect their personal and business lives.

Thinking of starting a business?

business structure options for Utah businesses

By Robert A. Youngberg

If you want to start a business, or if you already own one and want to operate it under another type of business structure, you may find this summary of rules for the different types of Utah businesses helpful.

Owners of Utah businesses may conduct business through a variety of legal structures: (1) a corporation, (2) a limited liability company (LLC), (3) a partnership, or (4) a sole proprietorship.

Here are some important things to consider when selecting a business structure:

- Protection of the owner from liability,
- Ease of transferring ownership,
- Continuation of the business after the death or withdrawal of an owner,
- Taxation.

The most common forms of business in Utah are:

Sole Proprietorship

If you start a business and you're the sole owner, and you don't choose to form it as a corporation or LLC, you have a sole proprietorship.

A sole proprietorship is the most common form of business structure. It is comparatively easy to form and operate: the single owner has sole control and responsibility, and therefore can make important business decisions more quickly.

Although a sole proprietorship may have to obtain a business license from a city or county, it does not have to register with the State. The owner obtains all business capital personally, and reports business profits as part of his or her individual taxable income.

However, a sole proprietor has no protection from personal liability for business debts and other obligations. The owner is personally liable for all claims against the business.

Partnership

A partnership is a business structure in which two or more people — or business entities, such as LLCs or corporations — associate as co-owners of a business for profit.

A partnership is created by a verbal or written contract between the partners.

There are two kinds of partnerships:

(1) General Partnership:

- Partners share profits and losses as agreed among themselves
- All partners are personally liable for business debts
- Files information returns with the IRS and the Utah State Tax Commission, then each partner is taxed at personal income tax rates
- Requires no registration with the State.

(2) Limited Partnership:

This form of partnership allows investors to limit their liability; that is, they leave management to the general partner(s), and their liability is limited to the amount of their investment.

- General partner(s) have full liability for business debts
- Limited partners are investors only; they take no part in management
- Creation is by filing documents with the State

Corporations

A corporation is a more complex form of business organization. It is a legal entity, or person, that exists apart from its owners, called shareholders.

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As a separate entity, it has its own rights, privileges and liabilities apart from its shareholders.

Utah has four types of corporations: (1) regular corporations, sometimes called "C" corporations; (2) "S" corporations, which enjoy special tax treatment; (3) professional corporations, which are owned and operated by people doing business in professions like medicine, dentistry, accounting, law and engineering; and (4) nonprofit corporations.

(1) "C" Corporations:

- Created by filing Articles of Incorporation with the Utah Department of Commerce
- Limited liability for shareholders
- Legal persons separate from their shareholders
- Require more extensive record keeping than other business types
- Pay taxes on their profits, and shareholders pay taxes on dividends; thus, their profits are taxed twice

(2) "S" Corporations

To become an S corporation the corporation must apply to the IRS. If approved, the S corporation will not pay income taxes; instead, like a partnership, it will report its income to the IRS and the Utah State Tax Commission, then distribute profits to its shareholders, who, like partners in a partnership, will be taxed at their own personal income tax rates. This way, with few exceptions, they avoid the "double taxation" of C corporations.

In exchange for this special tax treatment, an S corporation:

- May have no more than 100 shareholders; but spouses and close family members may be treated as one shareholder for purposes of calculating the limit.
- Must not be a member of an affiliated group of corporations
- Must not have corporations as shareholders, but must limit its shareholders to individuals, estates, and certain trusts
- All shareholders must be US citizens or residents.

IRS regulations contain further restrictions for certain types of income and business activities.

(3) Professional Corporation

People who are licensed in professions may not use business organizations to limit their personal liability to clients, but they may form corporations to limit their liability for

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the business aspects of their practices. For this purpose, Utah law allows licensed professionals to conduct business as professional corporations, or PCs.

- All shareholders, officers and directors must be licensed in the profession for which the corporation was formed, the only exceptions being the corporation's secretary and treasurer

- Individuals who are licensed in different professions may not do business in one corporation; thus, doctors and dentists, or lawyers and CPAs, may not do business together in one PC

- Business is started by filing Articles of Incorporation with the Utah Department of Commerce.

(4) Nonprofit Corporations

A nonprofit corporation is an organization formed for public service or the mutual benefit of its members, where profit is not a motive. It allows people to associate together for a common purpose while benefiting from limits on personal liability.

It's not a way to shield assets or avoid paying taxes. Rather, it's an organization that does not distribute its surplus funds to owners, but instead uses them to further its goals.

Examples of nonprofit corporations include charities, private foundations, labor unions, community fund-raising campaigns, neighborhood clubs, and community soccer and baseball leagues.

Consider incorporating your organization as a nonprofit when (a) you don't want any individual to own the organization's property or bank account; (b) you want the organization to continue on its own even after you and other members are gone; and (c) you want to protect officers and members from personal liability for the organization's activities.

Many nonprofit corporations are tax-exempt. However, incorporation does not guarantee tax-exemption, nor does it guarantee that contributors can deduct their gifts from reported personal income. For tax-exempt status a nonprofit corporation must apply to the IRS.

Generally, nonprofit corporations must follow the same organizational rules as other corporations.

Limited Liability Company

The limited liability company, or LLC, is Utah's newest form of business entity, and it's the most popular. That's because it combines many of the favorable characteristics of corporations and partnerships while avoiding many of the burdens.

The LLC gives its owners (called "members") limited liability for the company's debts and other obligations, while affording them the same favorable tax treatment that sole proprietors and partners in a partnership enjoy.

All limited liability companies have these things in common:

- Created by filing a Certificate of Organization with the Utah Department of Commerce.

- Allows members to manage the company themselves or elect managers, and all members may manage the company without risk of losing their limited liability.

- Has registration and annual reporting requirements similar to corporations and LPs.

- May choose to be taxed as either a corporation, a partnership or, if it has only one member, a sole proprietorship.

PLLC

Besides the option of doing business as a professional corporation, licensed professionals may do business as a professional limited liability company, or PLLC. A PLLC has the same filing, reporting and tax rules as a LLC, but like a PC, its owners and managers must all be licensed to practice in the profession for which it was organized. ❑

If you would like more information about the different forms of businesses, don't hesitate to call or write Rob Youngberg at the phone number or address listed below.

General Comparison of Utah's Most Commonly Used Business Types

	Sole Proprietor	General Partnership	Limited Partnership	Corporation	LLC
Method of Creation	Owner starts doing business	Agreement of the Partners	Registration with the State	Registration with the State	Registration with the State
Liability of Owners for business debts	Owner has unlimited liability	All partners have limited liability	Limited liability for limited partners only	Shareholders have limited liability	Members have limited liability
Transfer of ownership	May be sold at any time	Generally, sale of partnership interest by a partner ends the partnership	As determined by the partnership agreement	Unless otherwise agreed or prohibited by law, shareholders may sell or transfer shares as they wish	Unless otherwise agreed or prohibited by law, members may sell or transfer LLC interests as they wish
Control	By owner	Each partner has equal management authority, unless otherwise agreed	Management by general partner(s) only; limited partners have no management authority	Shareholders elect the Board of Directors, which sets policy and appoints officers	Management by members or appointed managers, depending on type of LLC and operating agreement
Taxation	Owner pays all taxes	Profits are allocated to each partner as agreed by the partners in their partnership agreement, and each partner pays tax according to the partner's own tax rate	Profits are allocated to each partner as set forth in the partnership agreement, and each partner pays tax according to the partner's own tax rate, even when profits are not distributed	Double taxation; corporate profits are taxed to the corporation; shareholder profits in form of dividends are taxed as they are received. If "S" election is made, corporation does not pay tax	IRS allows company to choose between taxation as a partnership or corporation, or if the LLC has only one member, taxation as a sole proprietorship