

## Business Organization\Tax Structure

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One of the first decisions a new business owner faces is choosing a structure for the business. Businesses range in size and complexity, from a self-employed plumber to a large corporation and can be organized in a variety of ways.

The principal types of business organizations are Sole Proprietorships, General Partnerships, Limited Partnerships, Limited Liability Partnerships, Corporations and Limited Liability Companies. Each structure has certain advantages and disadvantages. Factors such as taxes, type of business, insurance needs, number of owners and financial needs will determine how the business should be organized. Choosing the appropriate organizational structure for your business is one of the most important decisions to make and may require advice from an attorney, an accountant or another knowledgeable business advisor.

The following is a brief description of registration requirements on each type of business organization, as well as the variations of each structure. Again, it is advisable to have your legal counsel and/or accountant explain the advantages and disadvantages of each type of business organization before determining your business structure. In this chapter, you will find brief descriptions of each business structure.

### **Sole Proprietorship**

**Registration:** None

**Fee:** None

The sole proprietorship is the most common form of business structure.

- A sole proprietorship is a business controlled and owned by one individual and is limited to the life of its owner, so when the owner dies the business ends.
- The owner receives the profits and takes the losses from the business.
- This individual alone is responsible for the debts and obligations of the business.
- Income and expenses of the business are reported on the proprietor's individual income tax return and profits are taxed at the proprietor's individual income tax rate.

- Kansas has no state requirements to register or file the business name of a sole proprietorship.

### **Advantages**

1. A sole proprietorship has few formalities and low organizational costs.
2. Decisions are made by the owner.
3. There are fewer reporting requirements to government agencies.
4. Corporate "double tax" is avoided.
5. Business losses may be taken as a personal income tax deduction to offset income from other sources.
6. All profits are taxed as income to the owner at the owner's personal income tax rate.
7. Ability to do business in almost any state without elaborate formalities

### **Disadvantages**

1. Compared to corporations and partnerships, sole proprietorships cannot take advantage of certain benefits afforded by the Internal Revenue Code.
2. The business terminates upon death of the owner.
3. Investment capital is limited to that of the owner.
4. Loans are based on credit worthiness of the owner.
5. Owner's assets are subject to business liabilities. So for example, if a company truck is involved in an accident, the owner's personal assets (that is, bank accounts, cars, etc.) may be attached to compensate the injured party in some judicial proceeding or lawsuit.

A self-employed person, who does not expect to have employees, is not required to apply for a Federal Employer's Identification Number through the IRS. Form 1040 (Schedule C) must be filed with the federal government and a Kansas Tax Return with the Kansas Department of Revenue, on or before the 15th day of the fourth month following the close of the taxable year.

Note: Sole Proprietors and Partnerships are required to make estimated income tax payments if their estimated Kansas income tax, after all credits, is \$200 or more. Non-residents should consider only income from Kansas sources for meeting these conditions.

### **Tax Implications**

1. Profits are taxed as personal income on IRS Form 1040, Schedule C; and
2. For information on Social Security tax, refer to IRS Publication 533, and use Form 1040, Schedule SE.

### **Other Helpful Publications**

1. For estimated tax payments, refer to IRS Publication 505; and
2. To order Publication 583, Starting a Business & Keeping Records, contact the IRS at (800) 829-3676.

## **General Partnership (GP)**

**Registration:** Secretary of State-Optional, not required.

**Fee:** \$35.00

A general partnership is a business owned by two or more people (even a husband and wife), who carry on the business as a partnership. Partnerships have specific attributes, which are defined by Kansas Statutes.

- All partners share equally in the right and responsibility to manage the business.
- Each partner is responsible for all debts and obligations of the business.
- The distribution of profits and losses, allocation of management responsibilities and other issues affecting the partnership are usually defined in a written partnership agreement.
- The filings are optional and not mandatory.

### **Advantages**

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5. The filings are optional and not mandatory.

### **Disadvantages**

1. Each partner is personally liable for all the obligations of the business, not just his or her share. Thus, if a company truck is involved in an accident, each partner's personal assets may be attached by the court to help compensate the injured party.
2. Each partner has the power to act on behalf of the business, which requires that partners be chosen with care.
3. The partnership has no continuity of life. If any partner dies or becomes incompetent, such partner's interest is dissociated from the partnership and the partnership may be dissolved and reformed.
4. All partners must pay tax on their share of partnership profits, although profits may be retained in the business.
5. A general partnership has more opportunity than a sole proprietorship but less than a corporation, to take advantage of certain benefits afforded by the Internal Revenue Code.

For income tax purposes, a General Partnership functions as a conduit and not as a separate taxable entity. No tax is imposed on the Partnership itself (K.S.A. 79-32,129 et. seq.). Those carrying on business as partners are liable for taxes based on their percentage of ownership and

must file a Kansas Individual Income Tax Return (Form K-40) (K.S.A. 79-3220). Each individual partner is subject to the same reporting requirements and tax rates as the Sole Proprietor or individual. The Partnership must file a Kansas Partnership or S Corporation Income Tax (Form K-120S) each year to enable the State to determine who should be paying taxes relative to the Partnership.

Unemployment taxes need not be paid on the partners or for services rendered by individuals who are the children under 18 years of age, the spouse or the parents of any partners.

Partnerships are required to apply for a Federal Employer's Identification Number, whether they have employees or not.

### **Tax Implications**

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3. Each partner is responsible for all debts and obligations of the business.
4. The distribution of profits and losses, allocation of management responsibilities and other issues affecting the partnership are usually defined in a written partnership agreement.
5. The filings are optional and not mandatory.

### **Other Helpful Publications**

For more information, refer to IRS Publication 541 on Partnerships.

## **Limited Partnership (LP)**

**Registration:** Secretary of State

The Limited Partnership may be required to register the Limited Partnership's interest in securities with the Office of the Securities Commissioner.

**Fee:** \$165.00 Paper filing (Domestic/Foreign) or \$160.00 Electronic filing (Domestic only)

In a limited partnership, each partner is liable for debts only up to the amount of his or her investment in the company.

- Under Kansas Statutes a limited partnership must be formed in writing between one or more general partners and one or more limited partners.
- In addition, limited partners have no voice in the management of the partnership.
- Limited partnerships are ideal for property or for raising capital.
- Each limited partnership must have and maintain a registered office in Kansas that may or may not be the place of business.
- Additionally, a Kansas resident agent must be appointed, which may be an individual or a domestic or foreign business entity, such as a corporation, a limited partnership, a limited liability company, a business trust authorized to do business in this state, or the limited partnership itself.
- Registration with the Office of the Secretary of State is required.
- Interests in the limited partnership may be required to be registered with the Office of the Securities Commissioner.

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3. In addition, limited partners have no voice in the management of the partnership.
4. Limited partnerships are ideal for property or for raising capital.
5. Each limited partnership must have and maintain a registered office in Kansas that may or may not be the place of business.
6. Additionally, a Kansas resident agent must be appointed, which may be an individual or a domestic or foreign business entity, such as a corporation, a limited partnership, a limited liability company, a business trust authorized to do business in this state, or the limited partnership itself.
7. Registration with the Office of the Secretary of State is required.
8. Interests in the limited partnership may be required to be registered with the Office of the Securities Commissioner.

## **Disadvantages**

1. In a Limited Partnership, each partner is responsible for filing a Kansas Individual Income Tax Return (Form K-40), the same requirement as a General Partnership. A Kansas Partnership Return or S Corporation Income Tax (Form K-120S) must also be filed. A Limited Partnership Certificate must be filed with the Secretary of State.

## **Tax Implications**

1. The Partnership files an IRS Form 1065, but individual partners pay taxes on their share of profits shown on Schedule K-1 (Form 1120S) via Form 1040;
2. The Partnership must obtain a Federal Employer Tax Identification Number (FEIN, Form SS-4);
3. Partners may be subject to self-employment withholding, refer to IRS Publication 533.
4. For an explanation of taxation and forms, refer to IRS Publication 541.
5. A limited partnership requires advanced accounting procedures.
6. It does not live in perpetuity, but lives for a stipulated period, usually for the life of the assets it owns.
7. Limited partners have little voice in management once the investment is made in the partnership.
8. Interests may not be freely traded. Therefore, a limited partner must hold the investment indefinitely.
9. A Certificate of Limited Partnership and Annual Reports must be filed with the Office of the Secretary of State.
10. Annual financial reporting must be made to limited partners.

## **Other Helpful Publications**

For an explanation of taxation and forms, refer to IRS Publication 541.

## **Limited Liability Partnership (LLP)**

**Registration:** Secretary of State

The Limited Liability Partnership may be required to register the Limited Liability Partnership's interest in securities with the Office of the Securities Commissioner.

**Fee:** \$165.00 Paper filing (Domestic/Foreign) or \$160.00 Electronic filing (Domestic/Foreign)

A limited liability partnership is a partnership in which a partner's personal assets are shielded from claims for negligence, malpractice or other wrongful acts committed by other partners or the employees those partners directly supervise.

- A limited liability partnership does not shield any partners against their own acts, omissions or other partnership obligations.

- Each limited liability partnership must have and maintain a registered office that may or may not be a place of business in Kansas.
- Additionally, each limited liability partnership must have and maintain in the State of Kansas a resident agent which may be an individual or a domestic or foreign business entity, such as a corporation, a limited partnership, a limited liability company, a business trust authorized to do business in this state, or the limited liability partnership itself.
- Registration with the Office of the Secretary of State is required.
- Interests in the limited liability partnership may be required to be registered with the Office of the Securities Commissioner.

### **Advantages**

1. Investors have liability limited to their respective investments in the partnership.
2. The limited liability partnership is a separate entity and may sue and be sued, own property, protect its partners from unlimited liability, raise capital by selling interest in the partnership, borrow money and exist independently of its partners' mortality.
3. The limited liability partnership does not have to be reformed every time a partner dies.
4. The limited liability partnership can be perpetual.

### **Disadvantages**

1. They require advanced accounting.
2. Annual reports must be made to the Office of the Secretary of State.

### **Tax Implications**

1. A Limited Liability Partnership is required to apply for a Federal Employer Tax Identification Number, IRS Form SS-4.

### **Corporation**

**Registration:** Secretary of State

It may be necessary for Corporate securities to be registered with the Office of the Securities Commissioner.

**Fee:** \$90.00 Paper filing (Domestic & Professional)/\$115.00 Paper filing (Foreign) or \$85.00 Electronic filing (Domestic only)

The most complex business structure is the corporation.

- A corporation is a separate legal entity that is comprised of three groups of people: shareholders, directors and officers.
- The shareholders elect a board of directors that has responsibility for management and control of the corporation.

- Because the corporation is a separate legal entity, the corporation generally is responsible for the debts and obligations of the business.
- In most cases, shareholders are insulated from claims against the corporation.
- The corporation, as a separate legal entity, is also a separate taxable entity.
- Registration with the Office of the Secretary of State is required.
- It may be necessary for corporate securities to be registered with the Office of the Securities Commissioner.

A domestic corporation is one incorporated in Kansas. It must file Articles of Incorporation with the Office of the Secretary of State.

A foreign corporation is a business incorporated in a country, state or jurisdiction other than Kansas. In order to conduct business in Kansas, a foreign corporation must file an Application for Authority to Engage in Business in Kansas.

A professional corporation is comprised of a single professional or a group of professionals who file both Articles of Incorporation and a certificate from their specific Kansas professional regulatory board with the Secretary of State. Shareholders of a professional corporation are limited to members of that specific profession.

### **Advantages**

1. No shareholder, officer or director may be held liable for debts of the corporation unless corporate law was breached.
2. Interests in the business may be readily sold by the transfer and sale of shares.
3. The ready transferability of shares in the corporation facilitates estate planning.
4. If desired, a qualifying corporation may be taxed as a Subchapter S under the Internal Revenue Code.
5. Shares of the company may be sold to investors in order to obtain capital financing.
6. Corporations, to a much greater extent than sole proprietorships and partnerships, may take advantage of pension plans, medical payment plans, group life and accident plans and other benefits available under the Internal Revenue Code.
7. The corporate structure provides for a great deal of flexibility with respect to tax planning. For instance, income between the corporation and its shareholders may be adjusted, within reasonable limits, to obtain the most favorable tax treatment for each individual.
8. The entity exists forever, so long as corporate regulations are met. There is no need to cease operations if an owner or manager dies.

### **Disadvantages**

1. Cost of organization, legal fees and state filing fees can be expensive depending on the complexity and size of the business.
2. Control is vested in a board of directors, elected by shareholders rather than control vested in the individual owners. Thus, a shareholder who owns less than 50 percent of the stock may have a less than effective voice in how the business is run.
3. The possibility of double taxation exists.

4. Income from the business is taxed at the corporate level and again when the individual shareholders receive profits in the form of dividends.
5. The corporation must qualify in each state in which it chooses to do business.
6. Unlike sole proprietorships and partnerships, individual shareholders may not deduct corporation losses unless the corporation has elected to be taxed as a Subchapter S Corporation.
7. Annual Reports must be made to the Office of the Secretary of State.

The Corporation may be taxed under Subchapter C of the Internal Revenue Code (a "C" Corporation) or Subchapter S (an "S" Corporation). Kansas law provides for comparable treatment. A "C" Corporation reports its income and expenses on a Corporation Income Tax Return and is taxed on its profits at corporate income tax rates. Profits are taxed before dividends are paid. Dividends are taxed to shareholders, who report them as income, resulting in "double taxation" of profits, which are paid as dividends. If the Corporation meets the statutory requirements for "S" Corporation status, the shareholders may elect to be taxed as an "S" Corporation. The "S" Corporation is taxed in the same manner as a Partnership (i.e., the "S" Corporation files an information return to report its income and expenses, but it generally is not separately taxed). Income and expenses of the "S" Corporation flow through to the shareholders in proportion to their shareholdings and profits are taxed to the shareholders at their individual income tax rate. To elect to be an "S" Corporation, a Corporation must file Form 2553 with the IRS.

### **Tax Implications**

1. All forms of Corporations are required to file for a Federal Employer Identification Tax Number, Form SS-4;
2. Corporations must file an IRS Form 1120, which reports earnings and taxes profit;
3. Corporations may be subject to quarterly estimated tax payments; refer to IRS Publication 505.

### **Other Helpful Publications**

For more information on corporate taxes, request IRS *Publication 542*.

### **Tax Consideration**

1. There are two ways to tax a Corporation: as a C Corporation or as a Subchapter S Corporation. In an S Corporation, salaries of officers are deductible expenses and therefore reduce the amount of income subject to corporate income tax, but they are also subject to individual income tax. If salaries become too high, the IRS may treat a portion as a dividend from the Corporation. In a C Corporation, dividends are not deductible by the Corporation, resulting in double taxation, because the same money is taxed as a part of the corporate profit and as income to the individual.
2. In order to qualify under the Internal Revenue Code as a Subchapter S Corporation, the Corporation must file Form 2553 with the IRS and meet the following requirements:

3. Have at least one and no more than 75 shareholders (husband and wife can count as one shareholder);
4. Have no shareholders who are non-resident aliens;
5. Have only one class of stock;
6. Have no more than 80 percent of its gross receipts from outside the U.S.; and
7. Have no more than 20 percent of the Corporation's gross receipts from royalties, rents, dividends, interest, annuities and gains on sale or exchange of stock or securities.

Note: Every Corporation must make a declaration of its estimated income tax for the taxable year, if its Kansas income tax liability can reasonably be expected to exceed \$500 (K.S.A. 79-32,101). Any Corporation that began business in Kansas during this period is not required to file a declaration and no underpayment of estimated tax penalty will be imposed. Subchapter S Corporations must file a Kansas Small Business Corporation Form (Form 120S) and report income on individual income tax forms. Corporations doing business in Kansas, or deriving income from Kansas sources, must file a Kansas Corporate Income Tax Return, Form K-120. The corporate tax rate is four percent of Kansas taxable income, with an additional tax of 3.10 percent (2008) on income over \$50,000 (K.S.A. 79-32,110).

## **Limited Liability Company (LLC)**

**Registration:** Secretary of State

It may be necessary for the Limited Liability Company interests to be registered with the Office of the Securities Commissioner.

**Fee:** \$165.00 Paper filing (Domestic/Foreign or Professional) or \$160.00 Electronic Filing (Domestic only)

A limited liability company, or LLC, is a business entity that combines the limited liability of a corporation with the flexible management options of a general partnership.

- Each member of an LLC enjoys liability limited to that of the investment in the business and pays taxes in proportion to ownership share, thus avoiding the corporate malady of double taxation.
- Every LLC formed in Kansas must have at the end of the company name the words “limited company,” or the abbreviation “LC,” or “L.C.,” or “limited liability company” or the abbreviation “LLC” or “L.L.C.”
- An LLC must maintain a resident agent and file Annual Reports.
- Members of an LLC may be involved in the management of the business without incurring personal liability.
- If properly structured, an LLC may receive pass-through income tax treatment similar to a partnership.

- The professional limited liability company is comprised of a single professional or group of professionals, who file both Articles of Organization and a certificate from their specific professional regulatory board with the Office of the Secretary of State. The certificate must state that each member is duly licensed and that the company name has been approved. If the limited liability company is organized to exercise the powers of a professional association or corporation, each such profession shall be stated.
- A domestic LLC, one formed in Kansas, must file Articles of Organization.
- A foreign LLC, one formed in another country, state or jurisdiction other than Kansas, must file a Certificate for Authority to Engage in Business in Kansas/Foreign Limited Liability Company Application.
- It may be necessary for the limited liability company interests to be registered with the Office of the Securities Commissioner.

### **Advantages**

1. Liability of members of the limited liability company is limited to the amount invested.
2. An LLC has very flexible management options.
3. An LLC may be taxed as a partnership.
4. An LLC can be perpetual.

### **Disadvantages**

1. Transfer of interest is limited.
2. An investment is of limited liquidity since all members must vote to transfer a member's interest.
3. Annual Reports must be made to the Office of the Secretary of State.

### **Tax Implications**

1. Depending on your circumstances, an LLC may or may not require the use of a Federal Employer Identification Number. If you are not certain, seek competent professional help to advise.
2. Although the business structure resembles a Corporation, LLCs can be taxed as though they were a Partnership. The IRS has the ultimate say on taxation, but new Treasury regulations allow the LLC to indicate how it is to be taxed when filing;
3. In a LLC, each member must report income on Individual Income Tax Forms and file a Kansas Partnership Return or S Corporation Income Tax (Form K-120S).

### **Business Trust**

**Registration:** Secretary of State

**Fee:** \$65.00

The Business Trust has filing requirements similar to those required of Corporations. Specific questions about establishing a Kansas Business Trust should be directed to the Business Services Division within the Kansas Secretary of State's Office.

## **Franchise**

**Registration:** None

**Fee:** None

There are no registration requirements at the state level for the establishment of a Franchise. However, some cities have occupational licensing for business establishments. Businesses are categorized according to the North American Industry Classification System (NAICS). There are no distinctions made between a business that has a national Franchise agreement and one that is independently owned.

## **Nonprofit Corporation**

**Registration:** Secretary of State & Internal Revenue Service

It may be necessary to register debt securities with the Office of the Securities Commissioner.

**Fee:** \$20 Paper filing (Domestic only)/\$115.00 Paper filing (foreign) or \$20.00 Electronic filing (Domestic only)

Every not-for-profit corporation formed in Kansas must include in its name one of the words of incorporation which are "association," "church," "college," "company," "corporation," "club," "foundation," "fund," "incorporated," "institute," "society," "union," "university," "syndicate" or "limited," or one of the abbreviations "co.," "corp.," "inc.," or "Ltd."

- The not-for-profit corporation must designate:
  - a resident agent,
  - a registered office address,
  - a mailing address,
  - one or more incorporators, which can be either an individual or a business, and any directors.
- Registration with the Office of the Secretary of State is required.
- A not-for-profit corporation may need to register debt securities with the Office of the Securities Commissioner.

There are three main characteristics that distinguish a not-for-profit corporation from a for-profit business enterprise.

- Significant amounts of revenues are received from providers or entities that do not expect to receive either repayment or economic benefits relative to the amounts provided.
- There is no defined ownership that can be sold, redeemed or transferred, nor is there entitlement to a share of the assets if the organization is liquidated.

- The purpose of the operation is not to produce a profit.

There are more than 25 categories of tax-exempt organizations classified under Section 501(c)(3), and Section 501(a) of the Internal Revenue Code, as well as additional types of entities under other sections of the code. Some of the major classifications include: civic leagues, religious organizations, chambers of commerce, recreation clubs, social clubs, labor organizations, libraries, museums and voluntary health and welfare organizations.

An organization that wants to be a nonprofit entity must apply for tax-exempt status from the IRS and pay a user fee. Tax exemption is a privilege granted by Congress through the IRS. In return, nonprofit organizations are subject to a range of IRS requirements that differ from those for business enterprises. Among those is the requirement that a nonprofit organization's activities (income and expenses) be substantially related to its exempt purpose. A nonprofit organization must limit all partisan political activity, as well as limit lobbying activities. In addition, none of the nonprofit organization's assets can ensure benefit to any private individual.

Most nonprofit organizations are required to file an Annual Tax Return, Form 990. If more than \$1,000 of income is received, that was not related to the exempt purpose, Form 990T must be completed and taxes on those receipts paid.

The best course of action to take before starting activities is to seek competent professional help prior to assuming you are a nonprofit organization. For more information, contact the IRS at (800) 829-1040 or at [www.irs.gov/Forms-&-Pubs](http://www.irs.gov/Forms-&-Pubs). Or to order IRS Publication 557 Tax Exempt Status for Your Organization, contact the IRS at (800) 829-3676.