Last Modified on 09/01/2026 5:51 pm MDT

When creating a business entity, it is essential to consider which entity type best suits your business's needs. The type of entity that will be best for your business will depend on several factors, including personal liability protections, tax considerations, administrative and management needs, and capital needs. Below is a discussion of several of the key benefits and possible risks to consider before deciding which entity type you should form.

Sole Proprietorship

Sole proprietorships are best for businesses that are low-risk small businesses and do not require significant outside funding.

Key benefits: Sole proprietorships are the easiest to form. If you engage in business activity and are not registered as another type of entity, the business is automatically considered a sole proprietorship. Therefore, it is a low-cost option with little paperwork required. Additionally, under a sole proprietorship, the owner has complete control of the business. Taxes are also simpler under a sole proprietorship as the owner will report all business profits and losses on their personal tax return, rather than a separate business tax return.

Risks: The biggest risk of a sole proprietorship is that the owner will be fully personally liable for all business liabilities and debts because the liabilities of the business are not separate from the owner's personal liabilities. Having a sole proprietorship can also make it more difficult to raise outside funding. Sole proprietorships cannot issue stocks, and banks and investors may be more hesitant to lend money or invest due to the high risk of personal liability.

Partnership

Partnerships are for business with two or more owners (the owners may be individuals or entities). There are different types of partnerships, including general partnerships, limited partnerships, and limited liability partnerships. The partnership entity that will best serve your business again depends on the needs of you and your business.

General Partnership

General partnerships have two or more partners who all share in the management of the partnership.

Key benefits: General partnerships are another low-cost option to form. However, a partnership agreement is generally required, and even when not required, having one is highly recommended to avoid future disputes between partners. In general partnerships, all partners share in the management duties, which means they can share in the control and can all contribute capital. Taxes are also relatively simple under a general partnership, as the partners will report all business profits and losses on their personal tax return, rather than a separate business tax return. This allows general partnerships to avoid corporate taxes.

Risks: All partners are also personally liable for the partnership's liabilities and debts, so it is a higher-risk option for the individual partners. Having all partners involved in management can create its own risks in possible conflicts between partners. Additionally, general partnerships may dissolve if any of the partners leave the partnership (either by choice or if they die while acting as a partner), which would require restructuring of the partnership. However, the partnership agreement may provide otherwise. Finally, similar to sole proprietorships, general partnerships may have a more difficult time getting outside funding from banks and investors than other entities due to the unlimited personal liability.

Limited Partnership (LP)

LPs have a general partner, who manages the business, and limited partners, who contribute only capital.

Key benefits: The limited partners in an LP are protected from the liabilities and debts of the LP (but see the risks below regarding how they may lose this protection). The LP structure also allows the partners to avoid paying corporate taxes on profits and losses of the business. Additionally, this partnership structure may be more attractive to outside investors who want to contribute capital but avoid the personal liability and management duties they would have under a general partnership.

Risks: Unlike the limited partners, the general partner in an LP will be personally liable for the business's liabilities and debts. Additionally, limited partners may lose their liability protection if they become actively engaged in the management or control of the LP. LPs also have more requirements to form, including a partnership agreement and compliance with state regulations.

Limited Liability Partnership (LLP)

LLPs are generally used for professional service businesses, such as law firms or accounting firms. In fact, some states limit which types of business may register as an LLP.

Key benefits: The partners in an LLP generally have limited liability for the LLP's liabilities and debts, regardless of their involvement in the management of the partnership. Additionally, the partners are generally protected from the actions of other partners. Similar to the other partnerships, the business profits and losses are reported on the partners' personal tax returns.

Risks: The requirements to form an LLP differ by state, but LLPs have additional filing and reporting requirements than the other types of partnerships.

Limited Liability Company (LLC)

Limited liability companies are best for businesses that are higher-risk, have owners who want to protect personal assets, or have owners who want to have lower tax liabilities. LLCs combine several of the benefits of partnerships with several of the benefits of corporations.

Key benefits: The members of an LLC generally do not have personal liability for the business debts. LLCs also provide flexibility in both management and taxes. LLCs may be managed by the members or by a manager structure, allowing the business to choose the management style that will suit it best. Additionally, an LLC may choose how it wants to be taxed, allowing the business to pick the tax option that will provide the most benefits. It may choose to be taxed as a sole proprietorship, partnership, or corporation.

Risks: LLCs have formation and operation costs, although not as significant as the costs to form a corporation. While LLCs do have some tax benefits, members of the LLC may have to pay self-employment taxes on their profits depending on the requirements of the state(s) in which the LLC operates.

Corporation

Corporations are best for businesses that are higher-risk, plan to “go public” or be sold, or need significant outside funding. Corporations are independent legal entities. There are different types of corporations, but the following addresses the standard C corporation.

Key benefits: The owners, the shareholders, are not personally liable for the corporation’s liabilities or debts. The corporation structure also allows the business to get significant outside funding through the issuing of stock or through investors who are more likely to invest due to the liability protections. Corporations will also continue to exist despite changes in ownership. Finally, corporations are also eligible for business tax deductions that other entities are not eligible for.

Risks: It costs more to form corporations than other entity types, and there are also costs to maintaining the corporation. Corporations also have more administrative and operational requirements than other entity types, such as record-keeping procedures, ongoing compliance with state regulations, and mandatory reporting requirements. Additionally, while tax deductions are available, the corporation profits are subject to double taxation when the corporation profits are distributed to shareholders as dividends. Corporations must tax the business profits and the shareholders must report the dividends as personal income.