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CORPORATE TRANSACTIONS CLIENT ALERT

SHOOK
HARDY & BACON

Choosing Between a Corporation and a Limited Liability Company

A few friends decide to launch a small business. An established and successful company wants to create a subsidiary to expand into a new line of business. A large, multinational company aspires to enter the U.S. market. These and many other scenarios present a threshold decision: should we form a corporation or an LLC? While the answer to this question depends on the needs and wants of each business as well as on unique state laws, nearly every business will consider the following:

How They're the Same

Limitation of liability is perhaps the most important consideration for businesses of all sizes. Both LLCs and corporations limit shareholders' individual liability; a shareholder may lose its capital investment in the company, but a shareholder's personal assets are generally off-limits. This protection from liability is one of the key reasons most businesses prefer corporations and LLCs.

Ownership restrictions are minimal under the default state laws for both business types. Neither form restricts who can own shares of the company, and both forms allow 100% ownership by a single person or entity. A business should keep in mind, however, that ownership by a single person can reduce protection from personal liability in certain states. Under either form, a company may have one or more classes of shares with different rights and preferences.

How They're Different

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Complex business and financial deals frequently require expertise in multiple areas of law. With access to attorneys well-versed in corporate transactions, real estate, tax law and estate planning, Shook, Hardy & Bacon can help our clients stay nimble in a competitive marketplace while still protecting their assets and investments. To this end, we often find ourselves acting as transaction quarterbacks, assembling cost-effective teams from various other practice areas in the firm, including antitrust, employment and intellectual property.

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Tax treatment is among the most notable differences between a corporation and an LLC. Unless the owners choose to be taxed as a corporation, an LLC's profits and losses are "passed through" to the owners. These owners pay income tax on their portion of the profits and/or losses at their personal tax rates. A corporation, on the other hand, incurs double-taxation. Profits are taxed at the corporate level (at corporate rates), and any distributions to shareholders are taxed again at the shareholders' respective individual tax rate.

Flexibility is also a key concern for many businesses choosing between an LLC and a corporation. State statutes generally allow for greater flexibility in an LLC's operating agreement, which sets the framework for and governs the affairs and operations of the company. LLCs are creatures of contract; state laws typically allow the terms of the operating agreement, rather than state statutes, to control. In other words, the LLC form allows the owners to set the rules for management, share transfers, profit distribution and other business matters.

A corporation, on the other hand, must adhere to more extensive statutory requirements, including the observation of corporate formalities absent in the LLC context. For example, corporations must hold annual meetings and record meeting minutes, and states often require a prescribed notice period before a shareholder meeting. The increased reliance on statute has an advantage, however, in that the rules for corporations are more predictable than an LLC. Investors often prefer the predictability of statutory and case law inherent in corporations.

The attorneys in Shook, Hardy & Bacon's Business Transactions practice are well-versed in forming and advising new and existing businesses across the country, whether as a corporation, an LLC, or any other form. Please do not hesitate to contact us to discuss your business.

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