



# **Business Structure Options - *What Every Business Owner Should Know***

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# Sound Familiar?

- You formed your business and haven't revisited the structure since
- You're not entirely sure what the legal structure of your business is
- You've added owners, employees or other complexities since you started

# Structure Affects Multiple Things



- How much tax you pay



- How you make decisions/govern



- How protected you are when something goes wrong



- How attractive your business is when opportunity knocks

# Common Small Business Structures

- Sole Proprietorship
  - “I never formed anything”
- Limited Liability Company
  - Single member
  - Taxed as a partnership
  - Taxed as an S-corporation or C-corporation
- Corporation
  - Taxed as an S-corporation or C-corporation
- Limited Partnership/General Partnership

# Limited Liability Company

- The workhorse of small business
- Flexible ownership structure with pass-through taxation by default
- Personal liability shield (when property maintained)
- Governed by Operating Agreement
  - The LLC is only as strong as the agreement behind it
  - A one-page operating agreement is insufficient

# The S-Corp Election

- An “S-corporation” is a tax concept and tax election – not a separate entity type
  - An LLC or corporation can both be an “S-corporation” if a proper tax election is made
- Core benefits:
  - Self-employment tax savings on distributions above a reasonable salary
  - Corporation can obtain pass-through taxation
- Restrictions:
  - 100 shareholders max
  - One class of stock
  - U.S. persons (individuals) only

# The C-Corporation

- Not *typically* a preferred small business structure
- Entity-level tax + shareholder-level tax on distributions
- Built for:
  - Venture-backed companies
  - Owners who don't want annual tax attributes + Company desire to reinvest all profits back into operations
  - International ownership
- Governing documents:
  - Charter or Articles of Incorporation
  - Bylaws
  - Shareholders' Agreement
- Qualified Small Business Stock (QSBS)

# How Do You Choose?

- How many owners?
  - What are their relationships, both among each other and as between the owners and the company?
- What is the exit vision?
- Where are you operating?
- What is your liability exposure?
- What is the income/loss profile?
- What types of assets do you own?

# Ownership Analysis

- Solo founder vs multi-owner
- 50-50 ownership
- Active owners vs passive investors
- Employee owners

# Exit/Long-Term Vision Analysis

- Family legacy business vs grow and sell
- Sell to private equity or a strategic buyer (or employee)?
  - The wrong structure can complicate a deal – and discount your valuation
- Desire/need to raise institutional capital?

# Tax Analysis

- Pass-through vs entity-level tax
  - Tennessee Franchise and Excise Taxes
- Changing structures in the future can have tax consequences
- Run S-corporation models – compare to partnership or C-corp taxation
- If your attorney and your CPA have never spoken to each other about your business, that is a problem

# Common Mistakes

- Set it and forget it
- The handshake partner
- LegalZoom formation
- Poorly-drafted governance documents
- Blown S-Corp election
- Blown OME election
- Wrong state of formation

# Structure Review Triggers

- Taking on a new owner or equity partner
- Raising outside capital
- Granting equity or profit participation to key employees
- Contemplating a sale or ownership transition
- Material change in revenue or income profile
- Expanding operations into new states or markets

# The Ideal Structure

- Was an informed decision
- Fits your current business and your future plans
- Is supported by real, tailored governance documentation
- Is continuously maintained, and revisited from time to time

# Thank You



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