

13.1: Types of Businesses and Business Activities

Forms of Business Organizations

Accountants frequently refer to a business organization as an **accounting entity** or a **business entity**. A business entity is any business organization, such as a hardware store or grocery store, that exists as an economic unit. For accounting purposes, each business organization or entity has an existence separate from its owner(s), creditors, employees, customers, and other businesses. This separate existence of the business organization is known as the **business entity concept**. Thus, in the accounting records of the business entity, the activities of each business should be kept separate from the activities of other businesses and from the personal financial activities of the owner(s).

As you will see shortly, the business entity concept applies to the four main forms of businesses—single proprietorships, partnerships, and corporations. Thus, for accounting purposes, all four business forms are separate from other business entities and from their owner(s).

- A **single proprietorship** is an unincorporated business owned by an individual and often managed by that same person. Single proprietors include physicians, lawyers, electricians, and other people in business for themselves. Many small service businesses and retail establishments are also single proprietorships. No legal formalities are necessary to organize such businesses, and usually business operations can begin with only a limited investment. The most attractive feature of a proprietorship is that there is **no** “double taxation”. Both proprietorships and partnerships do not pay taxes on profits at the business level. The only taxes paid are at the personal level—this occurs when proprietors and partners pay taxes on their share of their company’s income. On the other hand, a business owner is personally liable for all debts of his or her company. This is called unlimited liability. If you’re a sole proprietorship and the debts of your business exceed its assets, creditors can seize your personal assets to cover the proprietorship’s outstanding business debt.
- A **partnership** is an unincorporated business owned by two or more persons associated as partners. Often the same persons who own the business also manage the business. Many small retail establishments and professional practices, such as dentists, physicians, attorneys, and many CPA firms, are partnerships. Unlimited liability is even riskier in the case of a partnership. Each partner is personally liable not only for his or her own actions but also for the actions of all the partners. If, through mismanagement by one of your partners, the partnership is forced into bankruptcy, the creditors can go after you for all outstanding debts of the partnership.
- A **corporation** is a business incorporated under the laws of a state and owned by a few stockholders or thousands of stockholders. Almost all large businesses and many small businesses are incorporated. The corporation is unique in that it is a separate legal business entity. The owners of the corporation are **stockholders**, or **shareholders**. Stockholders do not directly manage the corporation. They elect a board of directors to represent their interests.

Accounting is necessary for all forms of business organizations, and each company must follow generally accepted accounting principles (GAAP).

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